STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company	**:**	
	:	
Approval of its annual reconciliation	**:**	
of Purchased Water and Purchased	**:**	**09-0151**
Sewage Treatment Surcharges	**:**	
Pursuant to 83 Ill. Adm. Code 655.	**:**	

PROPOSED ORDER

DATED: May 4, 2012

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By the Commission:

I. INTRODUCTION AND PROCEDURAL HISTORY

Illinois-American Water Company ("Illinois-American," "IAWC," or "the Company") filed its Application for Approval of the Annual Reconciliation of Purchased Water and Purchased Sewage Treatment Surcharges with the Illinois Commerce Commission ("Commission"). IAWC therein requests that the Commission "approve its annual reconciliation of purchased water and purchased sewage treatment surcharges [for 2008], filed in compliance with III. Adm. Code 655" for various service districts.

Several Petitions for Leave to Intervene were filed and granted, including one by the People of the State of Illinois, by Lisa Madigan, Attorney General of the State of Illinois ("the AG"). Proposed testimony and exhibits were filed by IAWC, the Commission Staff ("Staff") and the AG.

Pursuant to due notice, initial and supplemental hearings were held in this matter before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois. Appearances were entered by respective counsel for IAWC, the AG and the Staff. Rich Kerchove and Kevin F. Hillen testified for IAWC. Larry H. Wilcox, Mary H. Everson and William Atwood testified for Staff. Dennis Streicher and Scott J. Rubin testified for the AG. At the conclusion of the hearings, the record was marked "Heard and Taken." Subsequently, initial and reply briefs were filed by IAWC, Staff and the AG. A proposed order was served on the parties.

II. STATUTORY AUTHORITY; APPLICABLE ADMINISTRATIVE CODES

Section 9-220.2 of the Public Utilities Act ("Act"), 220 !LCS 5/1-101 et seq., states, in part:

> (a) The Commission may authorize a water or sewer utility to file a surcharge which adjusts rates and charges to provide for recovery of (i) the cost of purchased water, (ii) the cost of purchased sewage treatment

> service, (iii) other costs which fluctuate for reasons beyond the utility's control or are difficult to predict, or (iv) costs associated with an investment in qualifying infrastructure plant, independent of any other matters related to the utility's revenue requirement. A surcharge approved under this Section can operate on an historical or a prospective basis.
> …
> (c) On a periodic basis, the Commission shall initiate hearings to reconcile amounts collected under each surcharge authorized pursuant to this Section with the actual prudently incurred costs recoverable for each annual period during which the surcharge was in effect.

Section 8-306(m) of the Act states:

> By December 31, 2006, each water public utility shall file tariffs with the Commission to establish the maximum percentage of unaccounted-for-water that would be considered in the determination of any rates or surcharges. The rates or surcharges approved for a water public utility shall not includes charges for unaccounted-for-water in excess of this maximum percentage without well-documented support and justification for the Commission to consider in any request to recover charges in excess of the tariffed maximum percentage.

Section 8-306(h) of the Act states:

> Water and sewer utilities; low usage. Each public utility that provides water and sewer service must establish a unit sewer rate, subject to review by the Commission, that applies only to those customers who use less than 1,000 gallons of water in any billing period.

83 Illinois Administrative Code 655 ("Part 655"), Purchased Water and Sewage Treatment Surcharges, implements Section 9-220.2 of the Act. Some of those provisions, including ones cited by the Parties, are as follows:

Section 655.10, Applicability, provides:

a) A purchased water/sewage treatment surcharge shall be applied to water/sewer bills of customers of water/sewer utilities in the applicable rate zone for utilities having a purchased water/sewage treatment surcharge rider and information sheet in effect and on file with the Illinois Commerce Commission (Commission).

b) A purchased water/sewage treatment surcharge shall be applied, during the effective month, in accordance with the provisions of this Part.

c) Each purchased water/sewage treatment surcharge shall be determined in accordance with Section 655.40 of this Part.

Section 655.30, Recoverable Purchased Water/Sewage Treatment Costs, provides:

a) Costs recoverable through the purchased water/sewage treatment surcharge shall include the following:

1) The cost of purchased water from an entity other than the utility (including wheeling or delivery charges); and

2) The cost of purchased sewage treatment from an entity other than the utility.

b) Recoverable purchased water/sewage treatment costs shall be offset by the revenues derived from transactions at rates not subject to the purchased water/sewage treatment surcharge to the extent that costs incurred in connection with such transactions are recoverable costs under subsection (a) above. Subsection (a) shall apply to transactions subject to rates contained in tariffs on file with the Commission, in contracts entered into pursuant to such tariffs, and in any other contracts providing for purchased water/sewage treatment.

c) Revenues from penalty charges approved by the Commission that relate to purchased water/sewage treatment shall offset recoverable costs as determined under Section 655.40 of this Part.

d) The determination of costs recoverable from customers through the purchased water/sewage treatment surcharge shall not include water used in, and/or sewage treated for, facilities either owned or leased by the utility.

Section 655.40, Determination of Purchased Water/Sewage Treatment Surcharge, contains formulas and other provisions applicable to the determination of surcharges.

Section 655.50, Annual Reconciliation, sets for rules and procedures applicable to the Annual Reconciliation filing, including schedules and other documentation to be submitted and timelines to be followed. Subsection 655.50(b)(3)(C) provides, “The reconciliation components shall not include costs associated with unaccounted for water or any storm water inflow or infiltration in contravention of an Order of the Commission directing that such costs not be reflected in rates.”

Section 655.60, Implementation, sets forth procedures and other requirements relating to implementation.

In addition, in 83 Ill. Adm. 600, Section 600.240, Inspection and Maintenance of Valves and Hydrants, provides:

> Each utility shall establish a valve and hydrant inspection program. Valves and hydrants shall be kept in good operating condition and should be inspected at least annually. Valves and hydrants found to be inoperable shall be repaired or replaced. Valve covers shall be maintained at grade level and not paved over. Each inspection and all maintenance performed shall be properly noted on the valve or hydrant record card.

III. PURPOSE OF PROCEEDING; CONTESTED ISSUES

IAWC assesses purchased water and sewage treatment surcharges pursuant to Section 9-220.2 of the Law, Ill. Adm. Code Part 655 and IAWC's surcharge riders. In this proceeding, IAWC seeks Commission approval of "its annual reconciliation of purchased water and purchased sewage treatment surcharges," for the 2008 reconciliation year, for eight purchased water areas and four purchased wastewater treatment areas as identified in Finding No. 5 below.

Contested issues addressed in both the evidentiary record and the briefs include IAWC's allowance for "unbilled-authorized consumption" and Staff's recommendation that IAWC be required to track unbilled-authorized consumption for a period of one year, as discussed below under Section IV, "Unbilled Water Issues"; and responsibility for excess sewerage flow charges imposed by the City of Elmhurst, as discussed in Section V below. An issue addressed in the briefs was a recommendation by the AG that the Commission establish a unit sewer rate for purchased sewage treatment for customers who use less than 1,000 gallons of water in a billing period; this issue is discussed in Section VI below.

IV. UNBILLED WATER ISSUES

As explained by Staff, IAWC purchases more water than it delivers to customers; the difference, referred to as non-revenue water ("NRW"), includes two subsets -- unaccounted for water ("UFW"), and water used under the category of "unbilled-authorized consumption." (Staff Initial Brief at 8-9)

In each of its service areas, IAWC's tariff sets forth a maximum percentage of UFW for which the Company is allowed to recover costs.

The amount of unbilled-authorized water consumption for which the Company seeks to recover costs is estimated at 1.25% as recommended in the American Water Works Association ("AWWA") M36 Manual. That is, in its reconciliation filing, IAWC included an amount of expense "for the 1.25% unmetered ("unbilled") but authorized consumption of water used for known purposes such as hydrant testing, hydrant flushing, main flushing, fire training, and fire fighting." (IAWC Initial Brief at 5) Staff agreed that "use of 1.25% of the quantity of water provided to a water system is a

reasonable estimate of the amount of unbilled authorized consumption … and is appropriate for this reconciliation." (Staff Initial Brief at 10-11) The AG disagrees, arguing that the Commission "should reject the 1.25% adder…." (AG Initial Brief at 12)

Staff and IAWC note that the Commission previously approved use of the 1.25% value, over the AG's objections, in IAWC Reconciliation Docket 08-0218.

A. The AG's Position

The AG argues that IAWC has not justified adding 1.25% to consumers' bills for Unbilled Authorized Consumption, and the AG makes several arguments in support of its position.

1. Unaccounted-for Water and Unbilled-Authorized Consumption

Section IV.A of the AG's initial brief is titled, "Rules Governing How Much Consumers Pay for Unaccounted-for-Water...Require That Unaccounted-for-Water Above the Tariffed Maximum Be Excluded From Purchased Water Reconciliation."

The AG states that subsection (m) of Section 8-406 (hereafter corrected to read "8-306") of the Act sets the amount of unaccounted-for-water that can be charged to consumers to the maximum stated in the utility's tariffs. According to the AG, although the law recognizes the possibility that a utility may request to recover more than the tariffed maximum, it only allows such recovery if there is well-documented support and justification. The Commission adopted an IAWC tariff setting the maximum unaccounted-for-water component for the purchased water areas subject to this reconciliation. (AG Initial Brief at 17-18; AG Reply Brief at 3-4)

The AG indicates that the tariff defines unaccounted-for-water as "the amount of water that enters the Company's distribution system and is not used for sales to customers or for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures." The tariff continues: "rates and surcharges shall not include charges for unaccounted-for-water in excess of the foregoing maximum percentages without well-documented support and justification for the Commission to consider in any request to recover charges in excess of these maximum percentages." (AG Initial Brief at 18)

The AG states that in this docket, IAWC increased the amount of unaccounted-for-water that it seeks to recover in each district by 1.25%. In those districts where the amount of water that entered its distribution system exceeded sales to customers by more than the unaccounted-for-water maximum, the AG says the Company increased the amount it could recover from consumers due to this 1.25% adder. The AG identifies the districts in which IAWC increased the amount of revenue it proposes to collect from consumers for 2008 to pay for unaccounted-for-water and increased recovery to include an additional 1.25%. (AG Initial Brief at 18-20) According to the AG, IAWC seeks to

increase the total “unrecovered” amounts it can charge consumers as a result of this reconciliation, totaling $191,276, excluding the minimal effect of South Beloit.

The AG asserts that IAWC asked to increase the maximum unaccounted-for-water in its last reconciliation docket, Docket No. 08-0218. The AG notes that the Commission allowed the 1.25% adder, over the objections of the AG and the Village of Homer Glen, as unbilled authorized consumption. According to the AG, the Commission did not say that the Company could permanently use the 1.25% adder, and the Company has not filed a modified tariff to increase the maximum unaccounted-for-water stated in the tariff. (AG Initial Brief at 20)

The AG argues that the statute and the tariff state that the unaccounted-for-water maximum cannot be increased above the maximums stated in the tariff without well-documented support and justification for the Commission to consider. The AG believes that despite this statutory directive, and the identical tariff language, the record on reopening made it clear that IAWC bases this additional charge on an unsupported premise that it is possible that water is being used for firefighting, street cleaning, and main flushing. The AG says IAWC admits that it does not track this usage, and that the 1.25% is based on an AWWA estimate. The AG argues that the AWWA estimate includes many more uses. The AG says the AWWA 1.25% estimate for unbilled, authorized consumption includes water used for: fire fighting and training; flushing water mains, storm inlets, culverts, and sewers; street cleaning; landscape/irrigation in public areas, landscaped highway medians, and similar area; swimming pools; construction sites, water for mixing concrete, dust control, trench setting, and water consumption at public buildings not included in the customer billing system.

In the AG's view, this is a significantly broader scope than the three uses IAWC referenced as the basis for the IAWC 1.25% adder (firefighting, street cleaning, and main flushing), and IAWC has not documented why the estimate for these seven categories of use is appropriate for the three categories of use it describes in its testimony. (AG Initial Brief at 21-22) The AG contends that IAWC does not know of any water used for many of these categories in the AWWA estimate and provided no documentation of water used for any of them. In the AG's view, this removes a substantial portion of the water that forms the basis of the AWWA M36 1.25% default number. (AG Reply Brief at 7-8)

The record demonstrates, the AG argues, that IAWC cannot document or provide any basis for an estimate of unbilled, authorized consumption to support the 1.25% figure. When asked specifically about the uses that are included in the AWWA estimate (excluding fire fighting and training), the AG states that IAWC responded for each item that it is not aware of any unmetered authorized water used from fire hydrants for street sweeping, or any of the other identified used, in 2008. However, the AG says IAWC suggests unreported use may have occurred without the Company’s knowledge. The AG claims this is consistent with the testimony of Mr. Kerckhove, who testified that the Company does not intentionally provide unmetered, or free, water to any entity that would use it for the purposes described in the AWWA manual. (AG Initial Brief at 22)

In its reply brief, Section II.C, the AG recommends that the Commission reject, as mere verbiage, IAWC's argument that it is not attempting to increase the tariffed UFW limit because unbilled, authorized consumption is not "unaccounted-for-water," but rather is a component of "non-revenue water." The AG says IAWC claims that it can "account" for 1.25% of its throughput, but only by reference to a default AWWA value. The AG claims IAWC did not offer a system specific value because it does not know whether the uses identified as "unbilled, authorized consumption" are actually present on its system, let alone how much water is used for these uses. The AG says IAWC has not cited any tariff authorizing unbilled usage. (AG Reply Brief at 6)

The AG argues that even assuming that there is a difference between "UFW" and "non-revenue water," IAWC's tariff defines the water subject to the UFW maximum. The AG says IAWC's tariff defines unaccounted-for water as the amount of water that enters the Company's distribution system and is not used for sales to customers or for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures. The AG says IAWC admitted that it does not know whether "unbilled, authorized" uses are actually occurring on its system. The AG insists that the Commission cannot allow IAWC to charge consumers for "authorized" uses that IAWC has no idea whether or the extent to which these uses are in fact occurring.

The AG suggests IAWC's resistance to tracking unbilled, authorized consumption, discussed below, may be based on the fact that there should not be much unbilled, authorized consumption on IAWC's system. The AG says unlike the typical public or municipal water system that does not bill municipal or government use, IAWC's policy is to bill municipalities for their usage. (AG Reply Brief at 7-8)

The AG argues that in addition to the fact that IAWC does not know of whether the unbilled uses identified by the AWWA in IAWC Ex. 1.0R, Attachment A, are actually occurring on its system, the AWWA standard is not intended to be used for billing purposes. The AG claims the standard is intended to provide a maximum benchmark to encourage water utilities to "attempt to establish permanent metering at unmetered sites" and not be wasteful. The AG believes IAWC's use of the 1.25% default value is inappropriate, and not consistent with the assumptions underlying the AWWA standard. (AG Reply Brief at 8)

In response to IAWC's argument that it used the AWWA default estimate of 1.25% "as a reasonable estimate" and that the Commission accepted that value in Docket No. 08-0218, the AG asserts Commission decisions are not *res judicata* or binding on subsequent cases. The AG also contends that unlike the evidence in docket No. 08-0218, in this docket, there is substantial factual evidence about what makes up the 1.25% adder that IAWC seeks to include in consumers' charges. The AG believes it is unfair to consumers and inconsistent with the regulatory process to ignore that evidence because in a prior case the Commission declined to disallow the adder as a matter of law. (AG Reply Brief at 8-9)

The AG argues that the evidence in this case demonstrates that IAWC has produced no evidence that it in fact has the uses on which the AWWA default is based. Irrespective of the conclusion in Docket No. 08-0218, where the AG says it and the Village of Homer Glen argued that the 1.25% adder was prohibited as a matter of law, the AG believes the evidence in this docket demonstrates that the 1.25% is not documented or justified for IAWC as required under the law, or used for "other known purposes" as required by IAWC's tariff. (AG Reply Brief at 9)

2. Water Used for Company Facilities

In Section IV.B.1 of its initial brief, the AG argues, "Section 655.30(d) of the Commission's rules expressly exclude[s] water used for Company facilities from the Purchased Water Reconciliation." (AG Initial Brief at 22)

The AG states that reconciliation of the charges and revenues for purchased water and sewage treatment services is subject to Part 655 of the Commission's rules and that Section 655.30 addresses "Recoverable Purchased Water/Sewage Treatment Costs." The rule states that "[t]he determination of costs recoverable from customers through the purchased water/sewage treatment surcharge shall not include water used in, and/or sewage treated for, facilities either owned or leased by the utility." 83 Ill. Adm. Code 655.30(d). The AG says that in his initial testimony, IAWC witness Mr. Kerckhove admitted that he did not review this provision before he submitted his testimony. Further, the AG says he admitted that IAWC made no adjustment to the 1.25% adder to the unaccounted-for-water maximum to account for water used for "facilities either owned or leased by" IAWC. (AG Initial Brief at 22-23)

The AG says Mr. Kerckhove confirmed on reopening that the Company had included water used for Company facilities in its reconciliation. According to the AG, he identified water used in the Southwest Suburban and South Beloit Districts for Company use and that he recommended that the Commission ordered "O" factor for South Beloit reduce the reconciliation amount by $19 for the fixed charge and $179 for the variable charge to reflect Company consumption of 193 ccf's. For Southwest Suburban, the AG says he identified 16 million gallons that were metered for Company use and that he determined that $359,565 was recoverable from consumers, down from $368,947 in the original Exhibit D for Southwest Suburban resulting in a Commission "O" factor of $9,382 for the Southwest District. (AG Initial Brief at 23)

The AG states that the amounts Mr. Kerckhove identified as Company-use water only include water used by employees and, apparently, does not include the quantity of water used for functions such as water testing, repairing main breaks, and upgrading infrastructure. To the extent that there is unmetered water used for these functions, the AG says the Company has not removed it from the reconciliation. It appears to the AG that water for these functions makes up part of the 1.25% the Company seeks to add to the tariffed unaccounted-for water maximum, further supporting the rejection of the 1.25% adder, in the AG's view. (AG Initial Brief at 24)

In Section II.D of its reply brief, the AG argues that contrary to the positions of the Company and Staff, the 1.25% adder should be rejected because water used in company facilities cannot be included in the purchased water surcharge, and the remaining authorized water, as reported in the LMO-2 reports, is de minimus. Section 655.30 of the Commission's rule on purchased water and sewage treatment reconciliation states:

> (d) The determination of the purchased water/sewage treatment surcharge shall not include water used in, and/or sewage treated for, facilities either owned or leased by the utility.

Notwithstanding this plain language, the AG says IAWC and Staff argue that the "intent" of the rule is that the utility can include water used in its facilities in the purchased water surcharge. The AG says that rather than addressing the actual language of the rule, IAWC tries to characterize AG witness Scott Rubin's plain reading of the rule as somehow "extreme" and "unyielding." The AG asserts that Mr. Rubin's reading of the rule is based on the unambiguous words of the rule and is consistent with a similar rule applicable to purchased natural gas reconciliation proceedings. (AG Reply Brief at 10-11)

According to the AG, "Administrative rules and regulations have the force and effect of law, and must be construed under the same standards which govern the construction of statutes." (AG Reply Brief at 11, citing *People v. Illinois Commerce Commission*, 231 Ill.2d 370, 380 (2008)) The AG states that in this case both IAWC and the Staff refer to the rule's "intent" without citation. The AG argues that Staff's attempt to distinguish between water used for customer benefit and water not used for customer benefit is found nowhere in the rule. The AG also believes Staff's reference to the fact that the Company uses purchases water for necessary maintenance activities does not imply that the rule allows the Company to charge consumers for that water pursuant to purchased water surcharge. (AG Reply Brief at 11)

The AG states that purchased water used for water testing, repair, flushing and water monitoring is used as part of the basic operations and maintenance of IAWC's system and, in the AG's view, operations and maintenance expenses are ordinarily recovered in base rates in a rate case. The AG says that in non-purchased water districts, IAWC includes the cost of water used in O&M activities. The AG believes Section 655.30 is consistent with this treatment of expenses, and provides the same incentive to efficiency associated with other base rate expenses. The AG asserts that by contrast, when the cost of purchased water is included in the purchased water surcharge, the Company loses this incentive to efficiency. The AG maintains that in this docket, IAWC has not even measured this usage, yet it still wants to increase the surcharge paid by consumers for this purported, unmeasured usage. (AG Reply Brief at 10-11)

According to the AG, the Staff and Company notion that this rule should not be read as written ignores the fact that the Commission's purchased gas adjustment surcharge rule contains a similar provision. The AG says the Staff witness who opined on the intent of Section 655.30 was not familiar with the Commission's natural gas rule; therefore, he did not know whether the purchased water surcharge rule is consistent with the natural gas rule, or how the latter has been applied. (AG Reply Brief at 11-12)

The AG indicates that 83 Ill. Admin Code 525.40(b) provides: "Determinations of the Gas Charge(s) shall exclude the estimated cost of gas to be used by the utility, based on the system average cost of gas for the effective month." The AG asserts this rule is consistent with the concept that purchased gas, or purchased water, used in company facilities should be treated as an ordinary cost of business and included in base rates.

The AG says that in Nicor Gas Company's last rate case, Docket No. 08-0363, the Commission rejected Nicor's request to establish a rider for the recovery of "Company Use" gas and expressly adopted this very reasoning. The Commission stated:

> The Commission finds that Nicor's proposed automatic rate adjustment for Company Use of gas should be rejected. Nicor is asking that its customers bear all risks associated with changes in actual gas prices. We find that this does not justify recovering this cost through a rider where Nicor would basically be permitted to automatically pass along its higher costs to its consumers. We agree with AG/CUB and Staff that, if Nicor were permitted to pass along these higher costs then it would have no incentive to control these costs and make the types of decisions that every other customer must make when energy prices increase. We further agree that there are alternatives to rider recovery of Company Use gas that Nicor has available to it, including filing for a base rate increase and requesting amortization.
>
> The Commission finds that Rider CUA does not present the appropriate means of addressing the year-to-year volatility in the market price of natural gas. (AG Reply Brief at 11, citing Docket No. 08-0363, Order at 149)

The AG also says that in Docket 09-0166/0167, the last Peoples and North Shore Gas rate case, the Commission noted that "cushion gas" was included in rate base. In the AG's view, these orders demonstrate that the "intent" behind the rule that purchased commodities, whether they are gas or water, is consistent with the plain language of the rule: that utility delivery companies are not to include the cost of the commodity used in its own facilities in customer purchased gas or water surcharges. (AG Reply Brief at 11)

The Commission observes that the AG did not cite and discuss these cases until its reply brief -- in which it addresses, among things, testimony by the Staff witness regarding the intent of language in the water surcharge rule -- which provided no opportunity to other parties to respond to them.

3. LMO-2 Reports

Section IV.B.2 of the AG's brief is titled, "The LMO-2 Reports That IAWC Files With the Illinois Department of Natural Resources Demonstrate that the 1.25% Adder Is Neither Well-Documented Nor Justified And Should Be Rejected. " According to the AG, the LMO-2 reports submitted to the Illinois Department of Natural Resources ("IDNR") showed that IAWC reported a substantially lower amount of unbilled, authorized consumption than the 1.25% IAWC seeks to add to consumers' bills. The AG says IAWC reported to the IDNR that only 0.27% of its delivered Lake Michigan water was used for unbilled, authorized consumption categories in 2008, and in 2009 it was only 0.19%. The AG asserts that IAWC identified 81% of this small amount of "hydrant use" consumption, which covers the same functions as unbilled, authorized consumption as used in its own facilities for water main flushing and sewer cleaning.

In the AG's view, when company-use water is removed from the reconciliation, consistent with Section 655.30(d) of the Commission's rules, the remaining unbilled, authorized consumption is insignificant. The AG asserts that for IAWC's largest purchased water district (Southwest Suburban), the change in the rate would be $0.0028 per 1,000 gallons. The AG contends that because the purchased water rate is stated to the nearest cent, it would make no difference whatsoever in the tariffed rate or in customers' bills. (AG Initial Brief at 25-26, AG Reply Brief at 4-5)

The Company used the 1.25% adder because that is a value from the AWWA Manual 36. In the AG's view, this general industry measure, which includes municipal systems as well as private systems, does not constitute well-documented support and justification or identify water used for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures. The AG argues that in contrast to the 1.25% general adder, the IDNR LMO-2 Reports contain specific estimates of water used for the same purposes IAWC identifies as unbilled, authorized consumption. (AG Initial Brief at 26)

The AG notes that Staff witness Atwood recommended that the Company track its actual unbilled authorized consumption. The AG says the Company claimed that it was not possible to track this usage, notwithstanding its LMO-2 Reports containing the same information. The AG recommends that the Commission deny the Company's request to increase the amount it bills consumers for unbilled authorized consumption so long as the Company declines or fails to provide specific documentation and justification for this use or offers information that is inconsistent with the LMO-2 Reports it files with the IDNR. (AG Initial Brief at 27)

According to the AG, IAWC and Staff argue that the LMO-2 was not designed, nor should be used, to estimate unaccounted for water, non-revenue water and unbilled authorized consumption for the Company's annual purchased water reconciliation. The AG says it never suggested that the LMO-2 should be used for any purpose other than for the "hydrant use" values because the functions covered by hydrant use are exactly the functions covered by the AWWA's unbilled authorized consumption. Furthermore, the AG asserts that IAWC witness Hillen testified that IAWC specifically reviewed the hydrant use reported in the 2008 LMO-2 reports before he testified in this docket, and made only minor changes. (AG Reply Brief at 5, citing Tr. 209-302)

The AG insists it is not "misusing" the LMO-2 report by referring to the hydrant use portion of the reports as actual "documentation" of unbilled authorized use, submitted to an Illinois agency. The AG believes that the fact that the LMO-2's hydrant use is so much lower than the 1.25% value IAWC claims as a default is strong evidence, specific to IAWC, that the 1.25% default is not representative of IAWC's actual system, is simply too high, and should not be used to increase customer rates beyond the unaccounted-for-water maximum contained in the tariff. (AG Reply Brief at 6-7)

The AG disputes Staff's complaint that the time periods for the LMO-2 and purchased water reconciliation are not identical. The AG says Mr. Rubin used two years to provide a check on the values to assure that the 2008 report was not an outlier. In addition, the AG says he reviewed the reports covering October 2007 to September 2009, encompassing calendar year 2008 that is subject to this reconciliation. (AG Reply Brief at 6)

The AG says Staff also asserts that the quantities listed on the LMO-2 forms are "roughly estimated and not accurate." The AG contends this statement is based on an IAWC response to a data request which was not part of the record, and furthermore, is a self-serving statement by the Company. According to the AG, Staff did not identify any independent investigation of whether the LMO-2 reports are "roughly estimated." In response to the Staff argument that the LMO-2 hydrant uses do not include all hydrant uses, the AG claims evidentiary record contradicts this statement. (AG Reply Brief at 6)

The AG also disputes Staff's argument that understating the water quantity under hydrant uses in the LMO-2 form results in a more conservative result when calculating the UFF. The AG believes that irrespective of whether the Staff thinks that IAWC "understated" its hydrant use or needed a higher or lower number to justify its UFF report, the Commission should not encourage inconsistency among reports (LMO-2 and purchased water reconciliations) when the Company is measuring the same thing. (AG Reply Brief at 6-7)

4. Tracking of Unbilled Authorized Consumption

Section IV.B.3 of the AG's brief is titled, "Tracking of unbilled authorized consumption." As explained more fully below, Staff recommends that IAWC track its

unbilled authorized consumption for a period of one year. IAWC objects to this recommendation. In Section II.E of its reply brief, the AG argues, "If IAWC Cannot in Any Way Track Unbilled, Authorized Consumption, Consumers Should Not Pay For It Other Than As Unaccounted-for-Water." (AG Reply Brief at 12-13)

B. IAWC'S Position

1. Unaccounted-for Water and Unbilled Authorized Consumption

In Section IV.a of its brief, "Unaccounted-for Water," the Company asserts that unaccounted-for water ("UFW") is distinguishable from non-revenue water ("NRW"). NRW "is defined as the overall difference between the quantity of water delivered to the water distribution system (water system delivery) and the quantity of water sold to customers from which revenue is derived (sales)." (IAWC Initial Brief at 7)

IAWC states that NRW includes both water uses that can be identified and accounted for (including water used by the utility for water main flushing and within its own facilities, as well as water used by municipalities for fire fighting, street cleaning and sewer main flushing), and water uses that cannot be accounted for, such as leakage or water main breaks.

IAWC adds that the subset of NRW that cannot be identified and accounted for as usage for a positive purpose is UFW – the measure of water produced that does not reach customers and is not otherwise accounted for. The Company says its tariffs for Lake Michigan water districts "specify the limit of UFW at which the cost of UFW may not be included in rates." (IAWC Initial Brief at 7)

In IAWC's view, AG witness Rubin intermixes UFW and NRW in error. According to IAWC, Mr. Rubin discusses Company increases in unaccounted-for water allowance for known, unmetered uses. (Id., citing AG Exhibit 2.0 on Reopening at 3-7) IAWC insists that at no time has the Company proposed in this docket to increase any of its unaccounted-for water limits. Rather, the Company says it has included a reasonable estimate of unmetered but authorized water use, water that is specifically excluded from UFW pursuant to the Company's Commission-approved tariffs. IAWC contends that recovery of reasonably estimated unbilled authorized consumption is permissible per the Company's tariffs and any adjustment to remove such consumption serves to violate the Commission-approved tariffs and should be denied. (IAWC Initial Brief at 7-8)

In Section II.a of its reply brief, "Unaccounted-for Water," IAWC says the AG mistakenly characterizes the 1.25% unbilled authorized consumption factor as an "adder" or increase to the UFW caps set forth in the Company's tariff. According to IAWC, the 1.25% factor represents a category of water that is separate and distinct from UFW. IAWC maintains that UFW is defined by this Commission-approved tariff as the amount of water that enters the Company's distribution system and is not used for sales to customers or for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures.

IAWC says the water included in the 1.25% factor is, by definition, not UFW, but rather is unbilled authorized consumption (i.e., water that is used for other known purposes - the volume of which is determined by reasonable estimation procedures.) (Id.) IAWC insists this category of water is recognized throughout the industry and is commonly utilized in such activities as firefighting, fire training, street cleaning, hydrant testing, sewer main flushing, and water main flushing. IAWC argues that the AG's statement on page 20 of its brief that "IAWC asked to increase the maximum unaccounted-for-water in its last reconciliation docket" is simply not correct. (IAWC Reply Brief at 3-4)

The Company says it has always maintained that the 1.25% unbilled authorized consumption factor was not a part of UFW. IAWC claims the Commission agrees that the 1.25% factor was not a part of UFW, asserting the Commission specifically found that the 1.25% factor falls under the heading NRW, not UFW. NRW is the basis for the 1.25% adjustment and that UFW percentages have already been established by tariff. IAWC says that given this Commission determination, it is puzzling that the AG continues to misrepresent the 1.25% factor as UFW. (IAWC Reply Brief at 4-5)

In Section IV.b of its brief, "**Unbilled Authorized Consumption Issues**," IAWC states that the level of unaccounted-for water that may be collected through the purchased water surcharge rider during the reconciliation year is defined in the Company's tariffs, specifically, ILL.C.C. No. 4, Third Revised Sheet No. 53.1 and First Revised Sheet No. 53.1. IAWC states that the tariffs define UFW as, ". . . the amount of water that enters the Company's distribution system and is not used for sales to customers or for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures." (emphasis added, Id. at 8)

According to IAWC, water used for known purposes but is not metered is referred to as unbilled-authorized consumption ("UAC"). IAWC argues that based upon the findings of numerous water audits worldwide, and as recognized by the Commission in Docket 08-0218, a default value of 1.25% is a reasonable estimate of unbilled-authorized consumption, according to the American Water Works Association ("AWWA") M36 Manual. The Company says it used the AWWA estimate of 1.25% as a reasonable estimate of water used for known, but unmetered, purposes. IAWC states that it "is this method used to estimate the use of water for other known purposes, water that the cost is properly recoverable in rates according to the Company's tariff, that AG witness Rubin takes issue with in this proceeding." (IAWC Initial Brief at 8)

The AG witness, as he did in the Company's previous purchase water reconciliation case (Docket No. 08-0218), proposes an adjustment to remove the 1.25% estimate of unbilled-authorized consumption that IAWC included in its calculations. IAWC contends that the same proposed adjustment was rejected by the Commission in Docket No. 08-0218, when the Commission found Mr. Rubin's position to be "in error" (Id. at 9, citing Docket No. 08-0218, Order at 10-11), in the Company's 2007

reconciliation, and the Company believes it should be rejected again. (IAWC Reply Brief at 5-6)

IAWC argues that in accordance with the Company's tariff, the cost of water that is used "... for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures," would properly be recovered as NRW. IAWC contends that because it, like many public water utilities, has not historically tracked all forms of authorized consumption, such as unbilled consumption for water used for firefighting, street cleaning, and water main flushing, the Company utilizes a default value of 1.25% as an estimate of such unbilled authorized consumption. IAWC maintains that the 1.25% utilized by the Company is consistent with the AWWA M36 Manual. According to IAWC, the M36 Manual provides that, based upon the findings of numerous water audits worldwide, a default value of 1.25% is a reasonable estimate of unbilled authorized consumption. (Id.)

AG witness Rubin's proposal to remove the 1.25% factor that IAWC included in its calculations to reflect the recovery of unbilled authorized consumption, IAWC states, is in direct contradiction to the positions of Staff, the Company, and previous Commission action. IAWC maintains that the 1.25% represents a properly recoverable NRW, not UFW, component that complies with the Company's purchased water surcharge rider tariffs, which describes the UFW component of purchased water. IAWC believes the Commission recognized as much in the 2007 reconciliation, Docket 08-0218: "Even absent water used for firefighting, water used for main flushing and street cleaning is either metered or accounted for by reasonable estimation procedures, and for that reason falls under the heading NRW, not UFW." (Id. at 9-10, citing Docket No. 08-0218, Order at 10) Further, IAWC says the relevant tariff language was considered and approved by the Commission in Docket No. 07-0425.

In Section II.B of its reply brief, "Unbilled Authorized Consumption Issues," IAWC claims the AG continues to erroneously argue that the 1.25% unbilled authorized consumption factor is not supported by appropriate documentation. IAWC maintains that the 1.25% factor is supported by and consistent with the AWWA M36 Manual. IAWC asserts that the AG's argument that the 1.25% unbilled authorized consumption factor is not supported by appropriate documentation is similar to the argument the AG made in Docket No. 08-0218, which was rejected by the Commission as being in error. (IAWC Reply Brief at 5-6, citing Docket No. 08-0218, Order at 10-11)

2. Water Used in Company Facilities

In Section IV.b.1, "Water Use in Company Facilities," IAWC states that as a general matter, water used in Company facilities is not recoverable through the purchased water surcharge as denoted in Section 655.30 d). The relevant language of Section 655.30 states, "The determination of costs recoverable from customers through the purchased water/sewage treatment surcharge shall not include water used in, and/or sewage treated for, facilities either owned or leased by the utility."

According to IAWC, the intent of this language is to disallow from recovery through the surcharge of incidental water used by the Company (e.g., to wash vehicles or watering Company landscaping). The Company claims it has removed from the reconciliation the cost of water used in its Southwest Suburban and South Beloit District facilities the cost of water used in these facilities, including water used for consumption by Company personnel performing duties for the benefit of customers, water used in kitchen facilities, water used in restrooms, water used for quality testing, and water used for chlorine monitoring. The Company believes that the intent of the rule is not to disallow the cost of water used for testing and for quality monitoring but has removed the cost nonetheless for this proceeding. (IAWC Initial Brief at 11)

IAWC says that in his testimony, AG witness Rubin argues to broadly expand the accepted understanding of water used in Company facilities to include, for example, chlorine monitoring, water quality testing, hydrant inspecting, and main flushing, all water uses that directly benefit customers. IAWC insists that water quality testing and chlorine monitoring is required by 83 Ill. Admin. Code 600.210, yet complains Mr. Rubin recommends that the cost of complying with the Commission's own rules be disallowed from the surcharge because the water is used in Company facilities. IAWC argues that water is used to flush mains in order to ensure high-quality water, yet complains Mr. Rubin recommends that the cost of the water used for main flushing be disallowed because the water passing through Company-owned pipes is not delivered to customers.

Further, IAWC asserts that water is used to flush fire hydrants in compliance with industry standards to ensure the hydrants' availability to deliver adequate water in the event of a fire, yet Mr. Rubin recommends that the cost of the water used for fire hydrant flushing be disallowed because the water passing through Company-owned hydrants is not delivered to customers. IAWC finds it ironic that Mr. Rubin makes this recommendation even though in Docket Nos. 05-0681, et al., Mr. Rubin testified that, "Public fire protection is one of the most important functions of a public water supply system," and that "... hydrants must be operated, tested, and maintained; and the underlying infrastructure (mains, storage, pumping, valves) also must be operated, tested, and maintained to ensure that everything will work during a fire." (IAWC Initial Brief at 11-12)

In IAWC's view, Mr. Rubin's "extreme" interpretation of the Commission's language in this regard also conflicts with the Staff understanding of the language governing water used in Company facilities. Taken to its logical conclusion, IAWC asserts that the "oddness" of Mr. Rubin's "unyielding" position can perhaps best be seen by the following: while Staff witness Mr. Atwood describes the intent of the language to prevent utilities from inflicting cost on customers for uses which provide little benefit to customers such as for landscape irrigation, application of Mr. Rubin's interpretation of the rule would actually permit the recovery of the cost of water used for irrigation since such water is not used in Company facilities but, rather, the water is used on Company facilities. (IAWC Initial Brief at 12-13; IAWC Reply Brief at 7-8)

3. LMO-2 Reports

Section IV.b.2 of IAWC's initial brief is titled "IDNR LMO-2 Reports." According to IAWC, AG witness Rubin primarily bases his recommendation to remove the cost of all unbilled authorized consumption on the Company's LMO-2 reports to the Illinois Department of Natural Resources for the fiscal year ended September 30, 2008. IAWC insists Mr. Rubin's reliance on the LMO-2 reports for this purpose is inappropriate for multiple reasons. First and foremost, IAWC asserts, the LMO-2 is not an Illinois Commerce Commission report, and is not intended to be used in the context of a purchased water reconciliation. Rather, IAWC claims the LMO-2 is filed annually with the IDNR. IAWC says the IDNR uses the report to monitor the adjusted water loss for each utility with a Lake Michigan lake water allocation. (IAWC Initial Brief at 13)

IAWC argues that these reports are high-level summaries of water usage for a water utility. IAWC claims the LMO-2 computes unaccounted-for flow by assigning a leakage rate per day per mile for cast iron pipes with lead joints and other types of pipes and joints, with the rate declining as the age of the pipes decreasing. IAWC asserts that no other variable, such as the number of service connections, is reflected in the formula-based unavoidable leakage worksheet included on the LMO-2. IAWC believes the LMO-2 method of computing unaccounted-for flow results in a utility's actual unaccounted-for flow being underestimated. (IAWC Initial Brief at 13-14)

In IAWC's view, the LMO-2 was not designed, nor should it be used, to estimate unaccounted-for water, non-revenue water, and unbilled-authorized consumption water for the Company's annual purchased water reconciliation. Rather, the Company says it has its own tariffs and the Commission has its own rules, standards, and reporting requirements that apply. 83 Ill. Admin Code 655.50, Annual Reconciliation, sets forth the procedures to be followed by a water or wastewater utility seeking initiation of a proceeding to review the annual reconciliation of revenues and costs under its Purchased Water and Purchased Sewage Riders and for the information that is to be provided to the Commission Staff. According to IAWC, AG witness Rubin attempts to misuse a report filed for a different purpose with an outside agency that is inappropriate and conflicts with previous Commission practice, and the AG's proposal to use the LMO-2 report in purchased water reconciliation proceedings should be rejected. (IAWC Initial Brief at 14, IAWC Reply Brief at 8-9)

4. Tracking of Unbilled Authorized Consumption

Section IV.b.3 of IAWC's initial brief is titled "Tracking of Unbilled Authorized Consumption." In his supplemental rebuttal testimony, as discussed below, Staff witness Atwood proposes that the Company track all forms of unbilled authorized water consumption for one reconciliation year after a Final Order is issued in the instant proceeding.

IAWC believes this proposal should be rejected given the difficulty in obtaining accurate information and the limited value such a requirement would achieve. First,

IAWC suggests one must consider the significant labor that would be involved in attempting to collect information. Considering the broad assumptions that would need to be made in attempting to estimate such usage, IAWC believes it becomes clear that the accuracy of such an undertaking would be severely handicapped. IAWC argues it is not possible to track all forms of authorized consumption as Mr. Atwood recommends. In the case of unbilled consumption for firefighting, IAWC says there are a number of authority, enforcement, accuracy and safety issues that prevent such tracking from being practical. For example, the Company claims it cannot force fire protection districts to mount hydrant meters prior to the commencement of fire-fighting actions.

Similarly, the Company says it is not possible for it to track water used by the fire protection districts for training and hydrant testing, particularly when the fire protection districts do not accurately measure and communicate to the Company the amount of water used. Further, even if the Company could require such action on the part of fire-fighters, IAWC suggests such requirements might raise safety concerns related to measuring devices encumbering the flow of water through hydrants. IAWC states that water that is used by external entities for authorized purposes, such as fire fighting, hydrant testing, training, street cleaning and dust control, is outside the control of IAWC and cannot be specifically tracked by the Company. Even if these entities volunteered to provide such information, the Company says it would have no ability to verify the accuracy of such data. Reliance on unaudited data that may be provided by external entities would almost certainly result in under-reported usage. (IAWC Initial Brief at 14-15, IAWC Reply Brief at 9)

Regarding water that is used by the Company for main flushing and valve and hydrant inspecting, IAWC suggests that this practice is not without its own challenges. For example, IAWC says such an endeavor would require the Company to make certain assumptions regarding water pressure or flow at each hydrant, and to reflect such assumptions in the calculation of water used. IAWC asserts that the calculation would also need to include the length of time that a hydrant is used and the diameter of the opening. IAWC also claims detailed records of each hydrant usage, for testing or main flushing, would need to be maintained and summarized for a future purchased water reconciliation. IAWC complains that this new practice will require additional resources (i.e., time and effort) as it involves expanded responsibilities for certain of its operations and administrative personnel.

Despite such record keeping and estimation, IAWC contends the amount of unbilled authorized consumption would be underestimated since authorized water usage outside the control of the Company would be excluded. IAWC says Mr. Atwood himself acknowledges the inherent difficulties in his proposal when he modified his original recommendation to indefinitely track all forms of unbilled authorized consumption in his rebuttal testimony. (IAWC Initial Brief at 15-16)

According to IAWC, the challenges inherent in the practices described above were contemplated by the AWWA, and served as support for its adoption of the 1.25% default value, which Staff supports in this proceeding and in the prior purchased water

reconciliation. IAWC states that the 1.25% value quantified in the AWWA M36 manual encompasses all unbilled authorized usage including usage outside the control of the Company. For these reasons, IAWC believes Mr. Atwood's proposal that the Company track all forms of unbilled authorized water consumption for one reconciliation year should be rejected. (IAWC Initial Brief at 16)

C. Staff's Position

1. Unaccounted for Water and Unbilled-authorized Consumption

In Section IV.a of its initial brief, Staff addresses "Unaccounted for Water." As explained by Staff, IAWC may purchase more water than it delivers to customers. The difference, known as non-revenue water ("NRW"), includes two subsets -- unaccounted for water ("UFW"), and water used under the category of "unbilled-authorized consumption."

In each of its service areas, IAWC's tariff sets forth a maximum percentage of UFW for which the Company is allowed to recover costs. (Staff Initial Brief at 8-9) The Company's tariff defines UFW as:

> the amount of water that enters the Company's distribution system and is not used for sales to customers or for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures.

IAWC states that UFW is a subset of Non-revenue water ("NRW"); and that NRW includes both UFW, and water use that can be accounted for, including water used for fire fighting, street cleaning, and main flushing. The Company defines UFW as the difference between water system input volume and authorized consumption. Staff concurs in the Company's definition of UFW. (Staff Initial Brief at 8)

In its reply brief, in response to the AG, Staff contends that the AG repeatedly mischaracterizes the Company's proposed 1.25% estimate of unbilled-authorized water consumption as an adjustment for UFW. Staff contends that unbilled-authorized consumption and UFW are two different and distinct things. Staff says UFW, as the name suggests, is the difference between water system input volume and authorized consumption: i.e., water that has, for practical purposes, been lost. Staff states that in contrast, unbilled-authorized consumption is water for which the Company is able to generally account, for which it does not or cannot bill a customer, such as water used for fire fighting, street cleaning, and main flushing. Staff insists that the AG's argument misses the difference between UFW and unbilled-authorized consumption, for which the 1.25% adjustment is intended to compensate, and is without merit. (Staff Reply Brief at 2-3)

In Section IV.b of its initial brief, Staff addresses "**Unbilled Authorized Consumption Issues**." The amount of unbilled-authorized water consumption for which

the Company seeks to recover costs is estimated at 1.25%. The unbilled-authorized water amount of 1.25% is recommended in the American Water Works Association ("AWWA") M36 Manual. (Staff Initial Brief at 8)

Staff indicates that the Company has not historically tracked all forms of unbilled-authorized consumption, such as unbilled consumption for water used for firefighting, street cleaning and main flushing. Instead, the Company uses the 1.25% default value in accordance with the M36 Manual – Water Audits and Leak Detection, as a reasonable estimate of unbilled authorized consumption.

Staff concurs with the Company that the use of 1.25% of the quantity of water provided to a water system is a reasonable estimate of the amount of unbilled authorized consumption, and that unbilled authorized consumption should not be considered a component of UFW. (Staff Initial Brief at 9-10)

Staff indicates that the Commission concurred in the use of the 1.25% factor in the last two reconciliation cases. Staff claims the Commission has repeatedly found the 1.25% adjustment to be reasonable in the past, and believes the propriety of the adjustment is undiminished by further litigation. Staff believes the use of 1.25% of the quantity of water provided to a water system is a reasonable estimate of the amount of unbilled authorized consumption, as described in the AWWA M36 Manual – Water Audits and Leak Detection, and is appropriate for this reconciliation. Staff also claims that re-litigation of this issue is decreasingly justified. (Staff Initial Brief at 10-11)

2. Water Use in Company Facilities

Section IV.b.1 of Staff's brief is titled, "Water Use in Company Facilities." Staff states that AG witness Rubin said costs associated with water used by the Company for flushing water mains and sewer mains are not recoverable from customers through the purchased water surcharge. More specifically, Staff states, the AG asserts that the actual amount of authorized unbilled usage should be further reduced since 83 Ill. Adm. Code 655.30(d) states that costs associated with water used by the Company for flushing water mains and sewer mains are not recoverable from customers through the purchased water surcharge. (Staff Initial Brief at 11)

655.30(d) states in its entirety:

> The determination of costs recoverable from customers through the purchased water/sewage treatment surcharge shall not include water used in, and/or sewage treated for, facilities either owned or leased by the utility.

Mr. Rubin asserted that water mains and sewer mains are "facilities" owned by the Company, and that water is "used" in these mains when the Company flushes them. He therefore claimed that such water usage is not eligible for inclusion in the purchased water surcharge. Staff claims that in advancing this theory, Mr. Rubin did not properly

characterize the use of water to flush mains. Staff notes that periodic flushing of water mains is required by Commission regulations and flushing/flow testing of fire hydrants are tasks that directly contribute to public safety and to the quality of water delivered to customers, and are also recommended by the AWWA. (Staff Initial Brief at 11-12)

The Staff engineering witness, Mr. Atwood, testified that periodic flushing of sanitary sewer mains helps to maintain the hydraulic capacity of the sewers, thereby helping to prevent the backup of sewage into homes and the overflow of sewage into streets and ditches. He said flushing also aids in the inspection of the sanitary sewers and in the discovery of any defects, and that these tasks directly contribute to maintaining adequate service to the customers and to maintaining public health and safety, and are also recommended by the Water Environment Federation. (Staff Initial Brief at 12)

In Staff's view, Mr. Rubin's interpretation of Section 655.30(d) is inconsistent with the rule's actual intent. Staff asserts that Section 655.30(d) is meant to prevent utilities from imposing costs on customers from which the customer potentially receives little or no benefit. Staff says such costs are likely related to use of water at Company offices and facilities that might serve other business interests, or costs for water uses that are superfluous such as landscape irrigation or vehicle washing. In Staff's view, it is illogical to read Section 655.30(d) in such a way as to prevent utilities from recovering costs for activities that are important to the proper operation and maintenance of their systems and that provide a benefit to the customers. Staff also asserts that water utilities in Illinois have always been allowed to recover these costs in previous purchased water surcharge reconciliations. (Staff Initial Brief at 12)

3. Use of IDNR LMO-2 Forms

In Section IV.b.2 of its brief, Staff addresses "Use of IDNR LMO-2 Forms." According to Staff, AG witness Rubin used data from the IDNR Water Use Audit Forms (LMO-2 forms) that the Company submits to IDNR to conclude that there is no support for the Company's use of a figure of 1.25% of water supplied as an estimate of unbilled authorized consumption. The AG contends the LMO-2 form's description of "hydrant uses" would encompass all water uses that make up the amount of unbilled authorized consumption and that the amount of water reported hydrant use is much lower than 1.25%. (Staff Initial Brief at 13)

AG witness Rubin testified that there is no support for IAWC's claim that it uses 1.25% of water purchases for known, unmetered (or authorized, unbilled) uses, based upon his review of LMO-2 forms. Staff says Mr. Rubin claims that data within the forms indicates that the Company's actual level of authorized unbilled water is much less than 1.25%. (Id. at 4-5) In Staff's view, these claims should be rejected. (Id.)

Staff states that LMO-2 forms are an annual audit report required and designed by IDNR to monitor the adjusted water loss for each utility with a Lake Michigan lake water allocation. Staff asserts that after making various allowed adjustments within the

LMO-2 form for normal leakage, hydrant use and other unmetered uses, the remaining non-revenue water is referred to as unaccounted-for flow ("UFF"). Staff says the IDNR asks the utility to maintain a long-term UFF below 8 percent. Staff states that if the UFF remains over 8%, the utility must initiate actions to help reduce non revenue water. (Staff Initial Brief at 13-14)

The Staff witness believes there are at least three reasons why IDNR LMO-2 form data should not be used to estimate or calculate the amount of unbilled authorized consumption for purposes of this purchased water surcharge reconciliation. First, the periods covered by the purchased water surcharge reconciliation year and IDNR's LMO-2 forms do not coincide. Staff says this reconciliation is for the calendar year 2008 while the LMO-2 forms cover the 12-month period from October 2007 through September 2008. Second, Staff says the quantities of water listed on the LMO-2 forms under hydrant uses are roughly estimated and not accurate. Third, Staff claims the water uses listed in the LMO-2 forms under hydrant use do not include all sources of unbilled authorized consumption. (Staff Initial Brief at 14, citing Staff Ex. 5.0 at 4-5)

Staff also states that one of the purposes of the LMO-2 form is to report UFF as defined by IDNR. Staff contends that understating the water quantity under hydrant uses in the LMO-2 form results in a more conservative result when calculating UFF. Staff asserts that due to difficulties regarding obtaining verifiable consumption information from entities outside of the Company's control (e.g., fire districts and departments), the Company has historically elected to under-report rather than over-report hydrant usage when completing the LMO-2 form. Staff believes that the LMO-2 form was not designed, and should not be used, to estimate unaccounted-for water, non-revenue water, and unbilled authorized consumption water for the Company's annual purchased water surcharge reconciliation. (Staff Initial Brief at 14-15)

4. Tracking Unbilled Authorized Consumption

Section IV.B.3 of Staff's brief is titled, "Tracking Unbilled Authorized Consumption." Staff recommends that the Commission order the Company to start tracking all forms of authorized consumption, such as unbilled consumption for water used for fire fighting, street cleaning, and main flushing. According to Staff, while IAWC is not opposed to estimating and tracking the authorized consumption of water used by Company personnel for main flushing and valve and hydrant inspecting, IAWC claims tracking the authorized consumption of water used by outside entities such as fire districts would be difficult and of questionable accuracy since it requires their consistent commitment to properly estimate, record, and report this water use. IAWC says there is no incentive for outside entities to provide usage information. Therefore, the Company believes it will be difficult to provide a fully traceable tracking of unbilled authorized consumption. (Staff Initial Brief at 15)

Staff states that despite these difficulties the Company identifies regarding the task of tracking authorized unbilled water consumption, in Docket No. 07-0425, the Company stated it would track all water used in authorized non-revenue generating

activities in the Alpine Heights, Chicago Suburban, Fernway, Santa Fe and Waycinden purchased water surcharge rider areas.

In addition, Staff indicates that IAWC's parent company, American Water, found the means to track such usage in its Pennsylvania Districts. According to Staff, the Company offers no explanation of any material differences between conditions in Pennsylvania and Illinois that explain why such tracking is acceptable to conduct in Pennsylvania, but is considered too difficult in Illinois. (Staff Initial Brief at 16-17, citing Docket No. 07-0425, Reply Brief at 9-10)

Staff recommends that the Commission order the Company to track unbilled authorized water consumption for one year. Staff also urges the Commission to order that the Company undertake a review of any available data on procedures and techniques used during its tracking program conducted in American Water's Pennsylvania Districts, and that the Company undertake sufficient discussions and correspondence with Staff to develop a satisfactory plan that outlines the various water uses to be tracked as well as the methods that will be used to track them. (Staff Initial Brief at 17)

D. Commission Analysis and Conclusions

In each of its service areas, IAWC's tariff sets forth a maximum percentage of unaccounted-for water ("UFW") for which the Company is allowed to recover costs. IAWC's tariff defines unaccounted-for water as "the amount of water that enters the Company's distribution system and is not used for sales to customers or for other known purposes as determined by meter measurement or, where no meter reading is available, by reasonable estimation procedures."

Section 8-306(m) of the Act provides, part, "The rates or surcharges approved for a water public utility shall not include charges for unaccounted-for water in excess of this maximum percentage without well-documented support and justification for the Commission to consider in any request to recover charges in excess of the tariffed maximum percentage."

Staff and IAWC view unaccounted-for water as one of the two subsets of non-revenue water ("NRW"). NRW was described as the amount by which the water purchased by IAWC exceeds the amount delivered to customers. The Company and Staff define UFW as the difference between water system input volume and authorized consumption. (Staff Initial Brief at 9; Reply Brief at 2-3) Examples of UFW cited by IAWC are leakage and main breaks. (IAWC Initial Brief at 7)

The other subset in NRW is water used under the category of "unbilled-authorized consumption." The amount of unbilled-authorized water for which the Company seeks to recover costs is estimated at 1.25% as "recommended" in the American Water Works Association ("AWWA") M36 Manual. That is, in its reconciliation filing, IAWC included an amount of expense "for the 1.25% unmetered ('unbilled') but

authorized consumption of water used for known purposes such as hydrant testing, hydrant flushing, main flushing, fire training, and fire fighting." (IAWC Initial Brief at 5) Staff agreed that "use of 1.25% of the quantity of water provided to a water system is a reasonable estimate of the amount of unbilled authorized consumption…and is appropriate for this reconciliation." (Staff Initial Brief at 10-11)

The AG, on the other hand, regards the 1.25% value as an increase by IAWC in "the amount of unaccounted-for-water that it seeks to recover…." The AG believes such recovery is contrary to IAWC's tariffs which provide that "rates and charges shall not include charges for unaccounted-for-water in excess of the foregoing maximum percentages without well-documented support and justification…." (AG Initial Brief at 18) The AG argues that the Commission "should reject the 1.25% adder…."

Staff and IAWC note that the Commission previously approved use of the 1.25% factor, over the AG's objections, in IAWC Reconciliation Docket 08-0218.

Having reviewed the record, the Commission first finds it reasonable to draw a distinction between unaccounted-for water and unbilled-authorized water, as urged by Staff and IAWC.

Staff reasonably characterizes UFW "as the difference between water system input volume and authorized consumption: i.e., water that has for practical purposes, been lost." (Staff Reply Brief at 2) By contrast, unbilled-authorized water is not water that has been "lost" due to leaks, main breaks or other causes. Rather, unbilled-authorized water is actually used -- but is not metered and billed -- for various known purposes such as hydrant and main flushing, street cleaning and fire fighting.

Whether the costs of water used for hydrant and main flushing are costs that are properly recoverable through the surcharge under the terms of Part 655 is discussed below, as is the question of whether use of the AWWA M36 Manual default value of 1.25 provides an appropriate estimate of the amount unbilled-authorized water usage.

As indicated above, the AG argues that the costs recovered in IAWC's 1.25% adder includes costs of **water used in Company facilities**, such as water used in Company mains when it flushes them, which is prohibited in Section 655.30(d) of Part 655. That subsection provides, "The determination of costs recoverable from customers through the purchased water/sewage treatment surcharge shall not include water used in, and/or sewage treated for, facilities either owned or leased by the utility."

Staff and IAWC take issue with the AG's position as discussed above. Among other things, Staff and IAWC assert that periodic flushing of mains and hydrants is required by Commission rules, and benefits customers, and that Part 655 is not intended to exclude recovery of those costs. (Staff Initial Brief at 11-12) Staff states that water utilities in Illinois have always been allowed to recover these costs in previous purchased water surcharge reconciliations.

In the Commission's view, the AG has raised an interesting argument. The question is not simply whether the water use was reasonable or customers benefitted. Although these tests have been met, the cost must also be one that is properly recoverable through the surcharge mechanism under the terms of the statute and the Commission rules authorizing the use of the surcharge.

Having reviewed the record and Part 655, the Commission finds that recovery of the costs in question is not precluded by Section 655.30(d). Although the term "facilities" is not defined, the language in 655.30(d), when viewed as a whole, suggests a narrower reading of the term than is offered by the AG. In that subsection, the word "facilities" appears only once. Recovery of costs of "sewage treated for [utility-owned] facilities" is also precluded. All things considered, it appears that the language as used in the context of 655.30(d) is intended to apply to such places as Company buildings or other structures where water is used or sewage is generated, rather than to water usage occurring in the Company-owned distribution system -- which is used to move purchased water to the customer -- or to hydrants connected thereto.

The Commission also observes that the AG's argument seems to be somewhat inconsistent with its position regarding unaccounted-for water, where the AG contends that some of the usages at issue are among those subject to the UAW allowance and maximums applicable thereto.

As discussed above, the AG also argues that the **LMO-2** reports submitted to the Illinois Department of Natural Resources ("IDNR") showed that IAWC reported a substantially lower amount of unbilled, authorized consumption than the 1.25% IAWC seeks to add to consumers' bills. IAWC and Staff offer several reasons, as identified above, why IDNR LMO-2 form data should not be used to estimate or calculate the amount of unbilled authorized consumption for purposes of this purchased water surcharge reconciliation. For example, an IAWC witness identified types of hydrant uses not reflected in the report. (IAWC Ex. 2.0R at 6)

As part of its argument regarding LMO-2 reports, the AG asserts that when "company-use water" is removed from the reconciliation, "consistent with Section 655.30(d) of the Commission's rules," the remaining unbilled, authorized consumption is insignificant. (AG Initial Brief at 25) As explained above, however, the AG's recommendation based on its interpretation and application of Section 655.30(d), which excludes "water used in [Company] facilities," is not adopted in this Order.

Upon consideration of the recommendations and evidence in the record, and the findings made above, the Commission agrees with Staff and IAWC that use the 1.25% value in the AWWA M36 manual provides a reasonable and more accurate estimate of the amount of unbilled-authorized consumption for such uses as hydrant and main flushing, firefighting and street cleaning, for the reconciliation year.

As discussed above, Staff also recommends, over IAWC's objections, that the Commission order the Company to **track unbilled-authorized water consumption** for

one year. Staff suggests that the Company be ordered to "undertake review of any available data on procedures and techniques used during its tracking program conducted in American Water's Pennsylvania Districts," and to "undertake sufficient discussions and correspondence with Staff to develop a satisfactory plan that outlines the various water uses to be tracked as well as the methods that will be used to track them." (Staff Initial Brief at 17)

Having reviewed the record, the Commission finds that the Staff recommendation should be adopted. The underlying issue has been a difficult and contentious one in several IAWC reconciliations, and tracking should be of benefit in accurately quantifying unbilled-authorized usages for future periods. Although IAWC objects to Staff's tracking proposal as being unnecessary, impractical and inaccurate, Staff points out that IAWC has previously stated it would track water used in non-revenue generating activities in some areas in Illinois, and that its parent company found the means to track such usage in its Pennsylvania districts. Thus, if IAWC wishes to continue to include an amount for unbilled-authorized consumption in its surcharge, then it is reasonable to expect the Company to track such usage for a period of one year as proposed by Staff.

V. EXCESS SEWERAGE FLOW CHARGES

In Docket No. 00-0476, the Commission approved, with conditions, IAWC's purchase of the assets of Citizens Utilities Company of Illinois ("Citizens"). Included in the transaction was the assumption by IAWC of Citizens' agreement with the City of Elmhurst reached in 1975. Under that Agreement, Elmhurst provides, among other things, treatment of sewage from IAWC's Country Club District. The Agreement contains a provision whereby the unit rate for treatment of Country Club District sewage is increased by a factor of 10 if the daily flows of sewage from the Country Club District exceed 600,000 gallons or the peak flow exceed 415 gallons per minute.

In 2008, the peak flow exceeded the contract limit in three separate instances during a six-day period of heavy rainfall, triggering the rate multiplier in the Country Club District. The charges for those excess flows totaled $44,399.

Staff recommends that responsibility for this amount be divided equally between IAWC and Country Club District customers. That is, Staff recommends that IAWC only be allowed to recover one-half of this amount from ratepayers. In its brief, the AG concurs in Staff's recommendation.

A. Staff's Position

Staff states that the City only began assessing the excess flow overage charges in late 2006. Due to issues with the accuracy of the excess flow metering and Company ownership of the metering system, Staff says the City did not have the physical ability to gather accurate measurements of the high flows, nor the legal authority to use them for billing until at least April 2006. (Staff Initial Brief at 17-18)

According to Staff, AG witness Dennis Streicher, former Director of Water and Waste Water for the City of Elmhurst, contends that the high flows experienced by Country Club's sanitary sewers during wet weather periods are due to the inflow and infiltration ("I/I") of extraneous water into the sewer system. Staff says that I/I is not the typical wastewater normally generated by customers.

Staff witness Atwood stated that inflow is surface water that directly enters the sanitary sewers via low lying manhole lids with defective covers, storm water inlets improperly connected to the sanitary sewer, illegally connected area drains on private property, basement sump pumps and customer-owned building foundation and footing drains. (*Id*. at 18, citing Staff Ex. 3.00 at 7)

Infiltration is ground water that enters the sanitary sewers through cracks, holes and defective joints in manholes, sanitary sewer mains and customer sewer service lines.

Staff states that the amount of I/I that a sanitary sewer collection system receives depends on many factors, including: water table elevation, age of the sanitary sewer system, pipe and manhole materials, the quality of construction, location of manholes, and the number of illegal I/I sources such as sump pumps, downspouts and area drains. Staff also indicates that I/I may result in wastewater quantities that are much greater than the sanitary sewers, pump stations and treatment plants are designed to effectively transport and treat. According to Staff, these results may include backup of sewage into homes, sewage overflows from manholes and interference with proper operation of treatment plants. Staff indicates that most sanitary sewer collection systems suffer from some degree of I/I, and there are no industry standards regarding acceptable levels of I/I. (Staff Initial Brief at 18-19)

According to Staff, the excess flow sewage overage charges to the Company's Country Club District can be quite significant. Staff says that in the 2008 reconciliation year, excess flows exceeding the Agreement limits occurred on only six days; however, the total charges incurred for excess flows on those six days was $44,398.68, which added 28% to the Country Club District's normal purchased sewage treatment cost (for all of 2008) of $158,682.32. (Staff Initial Brief at 19)

In Staff's view, the excess sewage flow overage charges were not entirely prudently incurred. Staff witness Atwood recommends the Commission find that the overage amount of $44,398.68, charged for the excess sewage flow exceeding the Agreement limits during the 2008 reconciliation year, be divided equally between the Company and its Country Club District customers.

Staff also recommends that the Commission find that the excess sewage flow overage charges for future purchased sewage treatment surcharge reconciliations for the Country Club District be divided equally between the customers and the Company. (*Id*.)

Staff believes the Commission is explicitly authorized to order the exclusion of costs associated with I/I. Section 655.50(b)(3)(C) states in full:

> The reconciliation components shall not include costs associated with unaccounted for water or any storm water inflow or infiltration in contravention of an Order of the Commission directing that such costs not be reflected in rates.

Staff notes that excess sewage charges were first assessed in 2006. IAWC states that 2008 was the third-wettest year experienced in Illinois and contends that Staff's excess flow charge cost-sharing recommendation implied the Company should have foreseen the extreme amount of rainfall received by its Chicago Metro Division. Staff says Mr. Kerckhove further argued that higher levels of I/I are as random as the weather, and the Company could not possibly have foreseen the above average rainfall that occurred in 2008, 2009 and 2010. (Staff Initial Brief at 20)

Staff asserts that the Company has been aware that the Country Club sanitary sewer system suffered from significant levels of I/I since at least as early as 2006, and certainly by 2008. Staff notes that the Company conducted a Sewer System Evaluation Study ("SSES") of the Country Club sanitary sewer collection system in 1999. Staff says an SSES is conducted when the sanitary sewer system owner realizes there is a significant amount of I/I. In addition, Staff indicates that AG witness Streicher informed IAWC of the high sewage flows experienced by Country Club several years before 2008 and that IAWC was told of Elmhurst's intention to install a meter to measure the high Country Club sewage flows in 2002.

Staff states that "the reason that the Company was not assessed excess flow overage charges by the City prior to 2006 was not because the I/I related excess flows didn't occur, but rather because the City did not have the ability to gather accurate measurements of the high flows until June 2004, nor the legal authority to use them for billing until April 2006 at the earliest." (Staff Initial Brief at 20-21; Staff Reply Brief at 7-8)

AIWC also asserts that the Staff's overage cost-sharing recommendation implied the Company should have foreseen the extreme amount of rainfall received by its Chicago Metro Division, and that the Company could not possibly have foreseen the above average rainfall that occurred in 2008, 2009 and 2010. Staff believes this mischaracterizes Staff's position. Staff says it has never stated in this docket that the Company should be able to foresee when heavy or extended precipitation and the associated I/I occurs. Staff argues, however, given the evidence presented during this docket regarding the existence of high sewage flows associated with I/I, the Company should reasonably have concluded several years ago that precipitation and associated I/I will occur from time to time. Mr. Kerckhove states in his Surrebuttal Testimony that higher levels of I/I are as random as the weather. Staff believes that while this statement is true as far as it goes, the fact that the excess flow overage problem only

occurs periodically does not absolve the Company of the responsibility to address it. (Staff Initial Brief at 21; Staff Reply Brief at 7-9)

According to Staff, the Company asserts that it has performed a significant amount of work on the Company owned "public side" of the Country Club sanitary sewer collection system and that all of the repairs recommended by the 2009 sanitary sewer evaluation study report for the Company owned portion of the sanitary sewer collection system have been completed. IAWC believes the remaining I/I issues are attributed to unauthorized connections on the customer owned sewer service lines and that the next step to reduce I/I is to encourage, and possibly force, those customers with illegal footing drains (a/k/a footer or foundation drains) connected to the sanitary sewer collection system to take corrective action to remove them, which is often difficult and expensive for the customer involved. (Staff Initial Brief at 21-22)

Staff acknowledges the work the Company has performed in 2009 on the Company-owned portion of Country Club sanitary sewers. Staff's review of the 2010 invoices from Elmhurst further demonstrates to Staff that the improvements completed on the Company's Country Club sanitary sewer collection system have reduced I/I and excess sewage flow overage charges during days with a significant amount of rainfall. Staff asserts that this information supports its opinion that the Company should have addressed the I/I problems sooner and that the Company is responsible for a portion of the excess sewage flow overage charges. However, Staff also believes that the Company should not completely ignore further investigation into I/I sources on its part of the system. Staff claims it is well known in the industry that I/I is persistent, and that one-time repair efforts are not commonly 100% effective in solving excessive I/I. (Staff Initial Brief at 22)

Staff concurs that one of the Company's next steps is removal of illegally connected foundation drains, notwithstanding the fact that footing drain removal is often difficult and expensive. Staff notes that the Company has established a grant-and-loan program to assist customers in addressing their illegal connections; however, as late as March 12, 2010, the Company has not pursued disconnecting theses sources of I/I. Staff indicates that these connections are in violation of the Company's Rules, Regulations, and Conditions of Service tariffs for sewer service which have been approved by the Commission.

Staff states that the Country Club District has 27 customers with illegal foundation drains out of an approximate total of 450 customers. Staff states that according to the 2009 SSES report, these foundation drains are responsible for over one third of the I/I received by the Country Club sanitary sewer collection system. Assuming the report is accurate, Staff insists it is inequitable for the approximately 423 customers with no foundation drain connections to subsidize the excess sewage flow overage charge resulting from 27 illegal foundation drains. Staff also notes that while the 2009 SSES report credits the 27 foundation drains as being a major source of I/I, there are up to 68 other types of defects such as cleanouts, drains and sump pumps

that the Company has apparently chosen to ignore as sources of I/I. (Staff Initial Brief at 22-23)

Staff observes that the Company has recently undertaken efforts to reduce the quantity of I/I and to renegotiate terms of the Agreement with Elmhurst. Staff believes, however, that the Company has been aware that the Country Club sanitary sewer collection system suffered from significant levels of I/I for several years, and nonetheless did not act to address it. Staff says the Company has also been aware that Elmhurst had the ability to impose extremely high charges for excess sewage flows, that Elmhurst was concerned with the high sewage flows from Country Club, and that Elmhurst intended to install its own flow measurement system to quantify the high flows. In Staff's view, it must be recognized that the Company owns the Country Club sanitary sewer collection system and has the ability to obtain customer compliance over the customers' portions of the system. Therefore, Staff claims the Company has the ability and responsibility to reduce I/I tributary to the sanitary sewer collection system. (Staff Initial Brief at 23-24; Staff Reply Brief at 7-9)

All things considered, Staff argues that it is apparent not all of the excess sewage flow overage costs were prudently incurred. Staff is unable to exactly quantify the amount of the overage costs that were prudently incurred. However, Staff believes it is not equitable that the customers should bear the entire burden of the overage charges for the I/I related excess sewage flows. (Staff Initial Brief at 24) Staff believes its recommendation is consistent with the Commission's "long-established definition of prudence" which is as follows:

> [Prudence is] that standard of care which a reasonable person would be expected to exercise under the circumstances encountered by utility management at the time decisions had to be made. In determining whether or not a judgment was prudently made, only those facts available at the time the judgment was exercised can be considered. Hindsight review is impermissible.
>
> Imprudence cannot be sustained by substituting one's judgment for that of another. The prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being 'imprudent'. (Staff Reply Brief at 6-7, citing Docket No. 84-0395, Order at 17)

Staff recommends that the Commission find that the overage amount of $44,398.68, charged for the excess sewage flow exceeding the Agreement limits be divided equally between the Company and its Country Club customers. This adjustment is presented on Staff Ex. 2.0, Schedule 2.4(CC). (Staff Initial Brief at 24)

B. The AG's Position

In its briefs, the AG argues, "IAWC Should Pay 50% of the Sewage Treatment Surcharges in the Country Club District." (AG reply Brief at 13; AG Initial Brief at 27-32) The AG states that consumers in the Country Club District have seen the cost of sewage treatment escalate over the last several years. The AG says that in 2009, IAWC asked the Commission for special permission to amortize a substantial under-recovery in the Country Club District for 2008. In a letter to the Manager of the Accounting Department, the AG says IAWC explained that IAWC incurred additional purchased sewer treatment costs during the five days that sewage flows exceeded the contract limit. If the cost were recovered in one year, the purchased sewage treatment charge would have increased consumers' monthly charge by $17.70, or 65% from $27.04 to $44.74. The AG indicates that the three year amortization resulted in a 26.8% monthly increase to $34.30 as of April 1, 2009. (AG Initial Brief at 28)

According to the AG, the increased charges in the Country Club District included $44,399 in "penalty charges" pursuant to a long-standing contract between IAWC and the City of Elmhurst, where IAWC transports sewage for treatment. That agreement contains a provision whereby sewage flows in excess of 600,000 gallons per day, or in excess of 415 gallons per minute, result in the rate per thousand gallons per day increasing by a factor of 10. (*Id*.)

The AG states that IAWC addressed the surcharges by commenting that a number of customers in the Country Club District had footer tile drains connected to the Company's sewer collection system, and the Company put into effect a grant and loan program to fund removal of these connections. However, the AG notes that the grant and loan program was not in effect in 2008. The AG also believes it is significant that little if any maintenance of the sewage collection system had occurred in the Country Club District between a 1999 sewer system evaluation study ("SSES") and a 2009 SSES. (AG Initial Brief at 28-29)

AG witness Streicher, the former Director of Water and Waste Water for the City of Elmhurst, testified about the City's experience with sewage flow levels from the Country Club District. According to the AG, the daily average water into the Country Club District was 110,000 to 130,000 gallons per day, or between 76.38 and 90.27 gallons per minute. It is the AG's position that any quantity in excess of that amount leaving IAWC's system is probably storm water or ground water entering the sanitary collection system and can be considered I/I. Mr. Streicher testified that I/I is an ubiquitous problem that requires consistent maintenance. He said a well-run system is one that never lets up on the maintenance of the system, and that you have to keep after it all the time. (AG Initial Brief at 29)

The AG states that when Mr. Streicher was the Director of Water and Waste Water at the City of Elmhurst he brought the problem of high flows to the attention of managers at IAWC. Specifically, the AG indicates that in 2002, he told IAWC of his intention to install a new city meter to monitor the sewage flows, and informed IAWC

representatives about high flows during wet conditions. Mr. Streicher believes there was a need for additional maintenance of the sewage collection system. (AG Initial Brief at 29-30)

The AG reports that after the new meter was in place in June, 2004, Mr. Streicher noted that flows exceeded the 415 gallons per-minute rate allowed in the agreement fairly frequently during wet weather events or when soil conditions were saturated. The AG states that nevertheless, the City could not assess the surcharge because the original meter was still in operation for billing purposes. The AG indicates that in March 2006 the IAWC meter failed and the high flows were brought to IAWC's attention. (AG Initial Brief at 30)

Mr. Streicher testified that he was not aware of any IAWC action to minimize excessive flows prior to 2008. In the AG's view, a lack of consistent maintenance during the several years leading up to 2008 demonstrates a lack of prudent management, particularly when coupled with the information the City of Elmhurst made available to IAWC to illustrate that its collection system was delivering more flow than was appropriate. (*Id*.)

The AG argues that the "imprudence" of IAWC's actions may be related to the fact that prior to 2006, the meter for sewage flows was not capable of detecting the rate of flow that would trigger the penalty in the 1975 Agreement. The AG asserts that IAWC was not motivated to address the maintenance and I/I issues previously due to the lack of a prior financial impact for delivering high flow rates. The AG says that until recently, the Company's customers had not been impacted by the sewer offload overage rate. The AG believes that prior to the assessment of penalties, which under IAWC's proposal only consumers pay, the Company demonstrated no motivation to address the I/I and excessive flow problems. The AG notes that the only action the Company identified to address I/I occurred after 2008. (AG Initial Brief at 30-31; AG Reply Brief at 13-15)

In assessing whether IAWC acted prudently in regard to incurring $44,399 in penalty charges in 2008, the AG says the Commission must review IAWC's maintenance of the sanitary sewer collection system in the Country Club District up to and including 2008. The AG adds that when evaluating prudence within the context of a reconciliation review, the Commission applies the standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. (AG Initial Brief at 31, citing *Illinois Power Co. v. Illinois Commerce Commission*, 245 Ill. App. 3d 367, 371 (3d Dist. 1993)) According to the AG, the courts and the Commission have been clear that in determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered, hindsight review is impermissible.

Although IAWC has cited to actions it allegedly took at address I/I and to maintain its system, the AG maintains that these actions occurred in 2009 and later. In the AG's view, IAWC has offered no explanation for why it failed to heed the warnings of

Mr. Steicher, on behalf of the City of Elmhurst, that its system was producing high flows as far back as 2002. The AG argues that IAWC also failed to act after the new city meter was installed in 2004, and high flows in wet conditions were part of the discussions about a new agreement. It is the AG's position that IAWC did not act prudently in foregoing maintenance and repair of its sewage collection system for 10 years, during which time a new meter capable of detecting high flows was installed, and the system continued to deteriorate. (AG Initial Brief at 31-32; AG Reply Brief at 13-15)

The AG states that Section 9-220.2(c) of the Act provides that the Commission must determine if reconciliation amounts are prudently incurred in the reconciliation review. The AG believes the evidence presented in this docket demonstrates that IAWC failed to take action to limit or control the high flows it delivered to the Elmhurst system, and incurred substantial penalties shortly after the City meter replaced the IAWC meter that was incapable of measuring high flows. The AG contends that IAWC did not conduct regular maintenance, until the results of its 2009 SSES demonstrated that the majority of the I/I (55%) came from the public, i.e., the utility system, rather than from private sources. The AG asserts that ordinarily, the engineers reported, two thirds of I/I is from private sources. In the AG's view, these factors along with the other evidence in the record support a disallowance of 50% of the penalties assessed under the sewage treatment agreement for imprudence. (AG Initial Brief at 32; AG Reply Brief at 16)

In its reply brief, the AG contends it is time for IAWC to have “some skin in the game.” According to the AG, the need for IAWC to have a financial incentive to address I/I and the condition of its sewage collection system is highlighted by its comments that having IAWC pay even half of these large increases provides a disincentive to consumers to correct I/I problems. The AG says this disincentive is several times greater if IAWC can simply pass the full amount of the surcharges on to consumers. (AG Reply Brief at 14)

C. IAWC's Position

IAWC disputes the 50/50 adjustment proposed by Staff and supported by the AG. IAWC asserts that due to record rainfall in Chicago during 2008, the peak flow exceeded the contract limit in three separate instances covering six days of significant rainfall, triggering the rate multiplier in the Country Club District. (IAWC Initial Brief at 17)

According to IAWC, rainfall is a source of sewer system inflow and infiltration (“I&I”) and affects the volume of water carried through sewer mains on the water’s journey to a sewage treatment facility. IAWC states that inflow is a “clean” water flow and results from footing drains and storm water sump pumps connected to the sanitary sewer system while infiltration, also a clean water flow, results from seepage of ground water into the sanitary sewer system through cracks and defective joints in mains, manholes, and customer service lines.

IAWC indicates that all sewer systems suffer from some level of I&I and no industry standard exists for defining an acceptable level of I&I. IAWC asserts that during high rainfall events, unauthorized connections of footer and storm drains to the sanitary system may dramatically affect the amount of sewer flows through the sanitary sewer collection system. (IAWC Initial Brief at 17)

Within the Country Club District, the Company provides purchased sewage treatment service to approximately 390 residential and commercial customers in or adjacent to the community of Elmhurst, Illinois. IAWC collects County Club's sewage and transports it to the City of Elmhurst for treatment and disposal. In the 2006 and 2007 Company reconciliation proceedings, the Company indicates it incurred treatment charges from Elmhurst that had been stepped up by a factor of 10 when the peak flows exceeded 415 gallons per minute during high rainfall events. IAWC insists such charges were properly included in the prudently-incurred costs of purchased sewage treatment service and recovered through the respective reconciliations as approved by the Commission.

IAWC states that in the 2008 reconciliation case, Staff witness Atwood, for the first time, proposes a sharing mechanism between the Company and customers for sewer overage costs charged by the City of Elmhurst when the level of flows exceeded 415 gallons per minute or 600,000 gallons per day. IAWC believes that in effect, Mr. Atwood is proposing that one-half of any such historically-prudent costs be disallowed. IAWC believes Staff's position should be rejected. IAWC also notes that AG witness Streicher discusses the issue of I&I but makes no recommendation with respect to the recovery of the excess flow charges under the contract between Elmhurst and IAWC. (IAWC Initial Brief at 18)

IAWC repeats that these excess charges were incurred under the terms of a contract between IAWC and Elmhurst. IAWC believes there is no basis on the record of this proceeding to conclude that such charges were in any way the result of imprudent action by IAWC. IAWC argues that it acted prudently with regard to I&I and that the charges incurred under the contract were prudent. According to IAWC, Illinois law requires that a utility be permitted to recover its prudently-incurred costs, and the Commission does not have discretion to authorize recovery of less than the utility's actual prudently-incurred cost of purchased water. (IAWC Initial Brief at 18-19, citing 220 ILCS 5/9-220.2(c); *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 166 Ill. 2d 111, 121 (1995); *Ill. Bell Tel. Co. v. Ill. Commerce Comm'n*, 414 Ill. 275, 286 (1953)) IAWC also asserts that the excess flow charges were in many cases the result of factors outside of IAWC's control.

IAWC argues that Mr. Atwood's proposal implies that the Company should be penalized for the extreme amount of rainfall that fell on the Chicago Metro District in 2008 and the resulting effects on the sewage collection system, despite the fact that the amount of rainfall is out of the Company's control. IAWC claims the reconciliation year 2008 was the third wettest year on record for the State of Illinois, according to the National Climatic Data Center ("NCDC"), and was the wettest year on record for the

northeast section of the state. According to IACE, the 6.64" of rain that fell in Chicago on September 13 was the calendar-day greatest rainfall in the history of Chicago. (IAWC Initial Brief at 19)

IAWC also contends that Mr. Atwood's cost-sharing proposal provides a disincentive to customers who have footer tile drain connections from disconnecting their footer drains from the sanitary sewer system. IAWC says AG witness Streicher attached to his rebuttal testimony, AG Exhibit 1.0 on Reopening, the Company's 2009 Country Club Sanitary Sewer Evaluation Study ("SSES"). IAWC indicates that the 2009 SSES identified potential public sector (Company-owned) sources of I&I and private sector (customer-owned) sources of I&I. The Company says the 2009 SSES presented recommendations to rehabilitate defects in the public sector but prioritized the work to be performed. "It is important that I[L]AWC ensure they have addressed all public sector sources of I/I prior to addressing the private sector sources." (AG Exhibit 1.4(a) Part 1, on Reopening, page 12) The Company claims it has addressed the public sector recommendations from the 2009 SSES, but the SSES cautioned that completion of the public sector rehabilitation may not significantly reduce I&I. (IAWC Initial Brief at 19-20)

The Company says the SSES identified numerous unauthorized connections as potentially significant sources of I&I. IAWC says these potential sources are not part of the "Company maintained" system, but rather occur on the customers' private property. IAWC states that AG witness Streicher acknowledged this and admitted that the City of Elmhurst struggles with its own unauthorized connections. The Company says it has implemented a grant and loan program that provides financial assistance to customers who elect to disconnect their footer drains from the sanitary sewer system. The Company adds that while the grant program provides funds up to $3,000 towards one-half of the cost to remove illegal connections, the loan program also provides interest-free loans of up to $5,000 for the remaining cost.

According to IAWC, it is currently more cost-effective for customers with footer tile drain hookups to pay for the full amount of the city of Elmhurst overage rates than to disconnect and correct the footer drain connections. IAWC believes Mr. Atwood's proposal to divide the costs of the overages between the Company and the customers will essentially guarantee failure of the grant and loan programs. IAWC claims customers will see no real benefit to spending up to $8,000, before assistance with the grant and loan program, when they can pay a modest increase in the monthly sewage treatment charge instead. IAWC also contends that these customer actions are essentially beyond IAWC's control. (IAWC Initial Brief at 20-21)

The Company also contends that because the footer drain connections occur on the "private" side of the sewage collection system, the only way for the Company to force customers to disconnect their footer drain connections is to discontinue their water service. IAWC says most of these "illegal" connections have been in place for many years, and could have been installed by a previous owner of the property. IAWC asserts that the customers with these connections may not have been aware that these

connections are prohibited by the Company's tariffs. The grant and loan programs are voluntary and the Company has no plan on discontinuing water service to non-participants at this time. The Company says it is genuinely interested in finding a reasonable solution to this challenging situation. (IAWC Initial Brief at 21)

IAWC also argues that the costs reflect the Company's actual costs for sewage treatment from the City of Elmhurst. IAWC maintains that the costs were incurred per the agreement between the Company and the City of Elmhurst for the treatment of sewage for customers in the Country Club District. The Company claims it has made a significant investment in the improvement of the Country Club collection system and will actively promote participation in the grant and loan program should the improvements not significantly reduce future overage charges from the City of Elmhurst. IAWC insists the costs were prudently incurred and should be recovered through the purchased sewage treatment surcharge. (*Id*.)

Mr. Atwood testified that there is no industry standard regarding the acceptable level of I&I in a sewer collection system. IAWC complains that Mr. Atwood's proposal unfairly imposes a standard, not set by industry experts or by a sufficient sample of homogeneous systems similar in size and nature to the Country Club system, but based solely upon the terms and conditions of a 33-year old agreement. IAWC also says the City of Elmhurst itself experiences I/I levels not unlike those of Country Club. IAWC maintains that costs incurred under the agreement with Elmhurst were prudently incurred and therefore are properly recoverable. IAWC believes any disallowance or sharing of costs assesses a penalty on the Company without basis to support such a penalty. (*Id*. at 22; IWAC Reply Brief at 10-11)

IAWC believes that if Mr. Atwood's intent was to incent the Company to evaluate and make improvements to the public side of the collection system, then Mr. Atwood's proposal is misplaced and strictly punitive, since the Company has already performed evaluation and rehabilitation tasks on the Country Club system. IAWC insists it has already performed an evaluation study of the entire sanitary sewer collection system in 2008 and 2009 and, as a result of this evaluation, system improvements, such as sewer lining and manhole rehabilitation, were completed in 2009. (IAWC Initial Brief at 22)

In its reply brief, IAWC also contends that over 1/3 of I/I is the result of illegal connections made to the sanitary sewer system by IAWC customers in Country Club, an issue which Staff agrees is difficult to address. IAWC says it has established a grant and loan program to assist customers with the expense of disconnecting their illegal connections from the sanitary sewer system, but all of the illegal connections remain. IAWC asserts that the illegal connections will continue to contribute to I/I. As discussed below, one option is for IAWC to disconnect these customers from the water supply network. Irrespective of the Commission's ultimate determination on the excess charge issue, if the Commission agrees with Staff that IAWC should pursue disconnecting these customers, IAWC suggests the Commission should state as much in its order in this proceeding. (IAWC Reply Brief at 11)

IAWC views Staff's claim that the Company has been aware that the Country Club sanitary sewer system suffered from significant levels of I/I since at least as early as 2006, and certainly by 2008 as a justification for Mr. Atwood's proposed imprudence disallowance, as unpersuasive and somewhat misleading. When considering the issue of utility prudence in the context of a reconciliation proceeding, IAWC suggests the Commission must consider the actions and decision of the Company in light of the facts available to the Company at the time the decisions were made. In 2008, IAWC claims it would have been aware of only three instances when the Agreement with Elmhurst had imposed increased charges.

IAWC says that in 2006 the amount was $20,252 resulting from only six significant rainfall events and in 2007 the amount decreased to $329. IAWC states that in both the 2006 and 2007 reconciliations, the respective amounts were found by Staff, and ultimately the Commission, to be part of the Company's prudently-incurred costs. Given the few days in 2006 when the Agreement flows were exceeded, and that only one incident occurred in 2007, the Company claims it would have had no reason to think that 2008 would be one of the wettest years in Illinois history. (IAWC Reply Brief at 11-12)

The Company says it initiated efforts during the 2008 reconciliation year to conduct another SSES in order to make the appropriate system improvements to minimize I/I. IAWC indicates notices were provided to customers in a letter dated October 10, 2008, that smoke testing would be taking place between October 21, 2008, and November 14, 2008. IAWC states that Elmhurst Community School District 205 was notified as well on October 14, 2008. IAWC says the Material Safety Data Sheet was prepared October 13, 2008, by the firm conducting the SSES. IAWC indicates dye Testing began December 30, 2008. The Company began to act on the sewage collection system during the reconciliation year, received the results of the SSES in February 2009, and completed all of the improvements on the public (Company) side of the collection system as recommended by the SSES. (IAWC Reply Brief at 12-13)

IAWC argues that based of the case law and the facts available to the Company at the time decisions were made, its actions regarding the Country Club system were prudent. IAWC claims that Staff acknowledges that the recommendations made by the SSES on the public side of the collection system have been completed. IAWC says Staff testified that its review of the 2010 invoices from Elmhurst further demonstrate that the improvements completed on the Company's Country Club sanitary sewer collection system have reduced I/I and excess sewage flow overage charges during days with a significant amount of rainfall. In IAWC's view, this work demonstrates that IAWC has acted and continues to act prudently both during the 2008 reconciliation year and the year following. (IAWC Reply Brief at 13-14)

The Company indicates its predecessor had conducted an SSES in 1999 and IAWC conducted its own SSES in 2008 and 2009. IAWC believes such timeframes between major studies is consistent with the 10-year cycle that AG witness Streicher testified a well-run system should seek to achieve. (IAWC Reply Brief at 14)

IAWC believes that Staff's proposal for the Commission to find that the excess sewage flow overage charges for **future purchased sewage treatment surcharge** reconciliations for the Country Club District be divided equally between the customers and Company should be rejected as the question of prudency should be considered on a case-by-case basis. IAWC asserts that questions regarding the prudency of the Company's actions in 2009 should be considered in the context of the reconciliation proceeding for that case. (IAWC Reply Brief at 15)

IAWC contends that Staff's own position in its Initial Brief suggests that IAWC has been prudent in its actions since 2009 and contradict Staff's request for a "permanent" sharing of excess costs. IAWC says it will take further actions to address I/I and those should be evaluated on their merits in the appropriate reconciliation. IAWC believes Staff's proposal results in a presumption of imprudence for future reconciliations which is prejudicial and a violation of due process. (*Id*.)

IAWC also responds to a statement on pages 22-23 of Staff's Initial Brief, that "one of the Company's next steps is removal of illegally-connected foundation drains, notwithstanding the fact that footing drain removal is often difficult and expensive." Staff states that "the Company has not pursued disconnecting theses sources of I/I."

According to IAWC, Staff correctly points out that the connections are in violation of the Company's Rules, Regulations, and Conditions of Service tariffs for sewer service which have been approved by the Commission. In the Company's view, however, disconnection from water service of customers with illegal drain connections is a serious and drastic remedy. Given that, if the Commission agrees with Staff that IAWC should pursue disconnections -- particularly if the Commission finds (though it should not) that the excess charges should be shared -- IAWC believes the Commission should state expressly in its order in this proceeding that pursuing water disconnection is appropriate and may be necessary. In so doing, IAWC says the Commission can ensure that there is no confusion as to what is the appropriate approach to resolving the illegal connection issue. (IAWC Reply Brief at 15-16)

IAWC says Staff witness Atwood argues that it is not equitable for all customers to share the burden of stepped up sewage treatment charges. As an alternative, IAWC suggests the Commission could find that only customers with illegal connections be responsible for the corresponding stepped up sewage treatment costs. (IAWC Reply Brief at 16)

D. Commission Analysis and Conclusions

In Docket No. 00-0476, the Commission approved, with conditions, IAWC's purchase of the assets of Citizens Utilities Company of Illinois ("Citizens"). Included in the transaction was the assumption by IAWC of Citizens' agreement with the City of Elmhurst reached in 1975. Under that Agreement, Elmhurst provides treatment of sewage from IAWC's Country Club District. The Agreement contains a provision

whereby the unit rate for treatment of Country Club District sewage is increased by a factor of 10 if the daily flows of sewage from the Country Club District exceed 600,000 gallons or the peak flow exceed 415 gallons per minute.

In 2008, the peak flow exceeded the contract limit in three separate instances during a six-day period of heavy rainfall, triggering the rate multiplier in the Country Club District. The charges for those excess flows totaled $44,399.

The high flows experienced by Country Club's sanitary sewers during wet weather periods were attributed to the "inflow" and "infiltration" ("I/I") of extraneous water into the sewer system. Staff states that I/I is not the typical wastewater normally generated by customers.

The Staff engineering witness testified that inflow is surface water that directly enters the sanitary sewers via low-lying manhole lids with defective covers, storm water inlets improperly connected to the sanitary sewer, illegally connected area drains on private property, basement sump pumps and customer-owned building foundation and footing drains.

He said infiltration is ground water that enters the sanitary sewers through cracks, holes and defective joints in manholes, sanitary sewer mains and customer sewer service lines.

Staff recommends that responsibility for the excess sewerage flow charges be divided equally between IAWC and Country Club District customers. That is, Staff recommends that IAWC only be allowed to recover one-half of this amount from ratepayers. In its brief, the AG concurs in Staff's recommendation. IAWC objects to Staff's proposal, as discussed above.

The Staff witness testified that the Company has been aware that the Country Club sanitary sewer system suffered from significant levels of I/I since at least as early as 2006, and certainly before 2008, and should have taken actions to address the problems prior to 2008.

The Commission agrees with Staff that IAWC should have begun addressing infiltration problems in the "public" side of the system -- where ground water enters the sanitary sewers through such places as cracks, holes and defective joints in manholes and sanitary sewer mains -- earlier than it did. The Company had knowledge of these problems and control over the sources and the repair of them. Customers should not have to bear the full cost of excess charges associated with infiltration.

Responsibility for the inflow problem, however, is more complicated. IAWC does not have effective control over the removal of unauthorized customer-owned building foundation and footing drains, other than by such means as disconnection of service which IAWC characterized as a drastic step. Although other Parties are critical of IAWC's handling of inflow problems, they do not appear to be specifically

recommending disconnection of offending customers. Accordingly, the Commission does not believe IAWC should be found imprudent in its incurrence of the portion of excess sewerage flow charges associated with inflow.

Staff notes that an SSES report stated that inflow from foundation drains is responsible for over one-third of I/I received by the Country Club sanitary sewer collection system. (Staff Initial Brief at 23) The Commission finds it reasonable to estimate that the other two-thirds of the I/I in the reconciliation year was associated with infiltration, and to apply Staff's 50/50 sharing to that estimate. Thus, the disallowance would be one-third of the $44,399 charge for excess flows, rather than one-half as proposed by Staff and AG, or zero as recommended by IAWC. The disallowance is reflected in Appendix B to this Order.

Regarding the responsibility for excess flow charges attributable to unauthorized connections, IAWC states, on page 16 of its reply brief, "As an alternative, the Commission could find that only customers with illegal connections be responsible for the corresponding stepped up sewage treatment costs." The Commission observes that this suggestion did not appear in IAWC's initial brief, and IAWC does not provide any citation to the evidentiary record with respect to it. The Commission welcomes input from parties with respect to this alternative in future proceedings, as well as other potential incentives intended to mitigate inflow problems.

As indicated above, Staff also urges the Commission to specifically find, in this docket, that the excess sewage flow overage charges for future purchased sewage treatment surcharge reconciliations for the Country Club District be divided equally between the customers and the Company. The Commission agrees with IAWC that such a finding would be premature. This recommendation from Staff will not be adopted.

VI. UNIT SEWER RATE APPLICABLE TO CONSUMERS WHO USE LESS THAN 1,000 GALLONS OF WATER IN A BILLING PERIOD

The AG argues Section 8-306(h) of the Act requires the Commission to establish a purchased sewage treatment unit rate that applies to consumers who use less than 1,000 gallons of water in a billing period. IAWC and Staff disagree with the AG's position.

A. The AG's Position

The AG states that in Section 8-406 of the Act (hereinafter referred to as 8-306), subsection 8-306(h) requires public utilities that provide sewer service to establish a rate that that applies only to those customers who use less than 1,000 gallons of water in any billing period. Section 8-306(h) states, "Each public utility that provides water and sewer service must establish a unit sewer rate, subject to review by the Commission, that applies only to those customers who use less than 1,000 gallons of water in any billing period."

The AG says at the time this law was enacted, IAWC assessed a flat fee for sewage collection and for sewage treatment of $45.52 per month. The AG believes that for low-use customers, this is a disproportionately high charge relative to use, and the General Assembly acted in 2006 to address this burden on low-use customers. The AG contends that charging a flat fee for sewage treatment and collection or for sewage treatment places a greater burden on low-use customers than a per-unit charge, and provides a disincentive to conserve. The AG says the General Assembly rejected this practice when it enacted Section 8-306(h). (AG Initial Brief at 32-33)

The AG indicates that in IAWC's first rate case after Section 8-306(h) was enacted, the Commission recognized that the law requires that a per-unit sewer charge be established. In addressing the sewage collection-only charge, the Commission said:

> The Commission's first task in resolving this issue is to determine whether Section 8-306(h) applies to both collection-only and collection and treatment sewer service. On its face, subsection (h) makes no distinction between the two types of sewer service. Nor have the parties provided any information which would allow the Commission to discern an intent by the General Assembly to exclude collection-only customers from the new requirements of subsection (h). Therefore, the Commission concludes that subsection (h) requires IAWC to establish a unit sewer rate for all sewer customers who use less than 1,000 gallons of water in any billing period. How IAWC concluded otherwise is unclear to the Commission.

The AG believes that in this docket the Commission should establish a purchased sewage treatment unit rate that applies to consumers who use less than 1,000 gallons of water in a billing period. (AG Initial Brief at 33)

The AG states that in IAWC's last purchased sewage treatment reconciliation docket, Docket No. 08-0218, the Commission "erroneously" held that Section 8-306(h) did not apply to purchased sewage treatment charges. Docket 08-0218, Order at 9-11. The AG asserts that this conclusion by the Commission is wrong as a matter of law. The AG argues that there is nothing in Section 8-306(h) that excludes surcharges for purchased sewage services (treatment or collection) and no reference to exclude rates subject to reconciliation under Section 9-220.2. (AG Initial Brief at 33-34)

According to the AG, Section 8-306(h) applies generally to sewer rates: it does not list each and every type of sewer rate, including some while excluding others. The AG claims there is no more reason to exclude purchased sewer charges from the statute than there was to exclude collection-only sewer charges, which the Commission declined to do in IAWC's last rate case, noting that it was "unclear" how IAWC could conclude otherwise. The AG believes there is nothing ambiguous about Section 8-306(h), and it must be read as written. (AG Initial Brief at 34)

The AG states that Section 8-306(h) refers to "sewer service" without any modification. The AG contends that while the present docket is a reconciliation docket,

the very purpose of a reconciliation docket is to set rates for sewer services. The AG believes that Part 655.40(b), the rule requiring a fixed monthly charge, has been superseded by statute, and should not be applied in a way that conflicts with Section 8-306(h). (AG Initial Brief at 34)

The AG contends that without reaching the question of whether Part 655.40(b) of the Commission's rules conflicts with the statute, the Commission administrative rule that provides that purchased sewage treatment surcharges be calculated as a flat rate that does not vary with the level of water used is not unconditional. Specifically, Section 655.40(b) states:

> For recovery of purchased sewage treatment costs, if the utility's cost for purchased sewage treatment does not vary based on the strength of waste treated, the sewage treatment surcharge shall consist of a monthly charge.

The AG asserts that the mandate to adopt a fixed monthly charge for purchased sewage treatment is contingent on a finding that the cost of treatment does not vary based on the strength of the waste treated. The AG says there is no evidence in this docket one way or the other to indicate if the cost varies based on strength. (AG Initial Brief at 34)

The AG states that in determining the monthly charge, the Company simply took the total sewage treatment cost and divided it by the number of customers, using an average volume of treated water. The AG indicates that the effect was equal to charging each consumer as if they used 10.68, 11.68, and 13.46 thousand gallons per month in Country Club, Valley View, and Rollins, respectively. According to the AG, the average resident in the Chicago Metro area uses between 5,000 and 6,000 gallons of water, but are charged for the equivalent of treating more than 10,000 gallons of water. The AG asserts that the volume of water being treated implies very high water usage that is at odds with consumers' actual usage. (AG Initial Brief at 35)

The AG claims there is no indication in the exhibits or in IAWC's testimony that the cost of treatment varies based on the "strength of the waste treated" or that costs vary based on whether an account produces more or less storm wastewater as opposed to more or less sewage wastewater. In the absence of such a finding, the AG contends the Commission's rule does not mandate that a fixed monthly charge be used, and therefore does not conflict with Section 8-306(h). (*Id*.)

The AG argues that even if there were a conflict between the Commission's administrative rules and Section 8-306(h), the statute controls. "It is axiomatic that the authority of an administrative agency or department to adopt rules and regulations is limited by statutory language under which the rules are to be adopted. To the extent that any such rule, although adopted in conformity with the rule making procedure, is in conflict with the statute it is invalid." (AG Initial Brief at 35, citing *Pye v. Marco*, 13 Ill. App. 3d 923 (1973); *Hadley v. Department of Corrections*, 224 Ill.2d 365

(2007)(invalidating regulation in conflict with statute); *Montgomery Ward Life Insurance Co., v. State*, 89 Ill. App. 3d 292, 302-303 (1980)). The AG insists that the Commission's administrative rule cannot be used as an obstacle to implementing the directive of Section 8-306(h).

The AG asserts that the same total sewage treatment cost in each district can be recovered by a gallons-of-use charge, rather than on a flat fee average basis. The AG believes a per gallons-of-use charge will not burden low-use customers with charges that are disproportionate to their use and is consistent with the policy adopted by General Assembly in Section 8-306(h). The AG states if the Commission orders the Company to convert to a volumetric or some other form of unit sewer rate, the Company can do so. The AG believes the Commission should order IAWC to prepare a per-unit charge as mandated by Section 8-306(h) of the Act. (AG Initial Brief at 36)

Section IV.E of the AG's brief is titled, "The Need for a Per Unit Sewage Treatment Charge is Further Supported by IAWC's Repeated Under-Collections That Drove Up Purchased Sewage Treatment Costs By As Much As 80% In 2008." (AG initial brief at 36)

The Commission observes that it is somewhat unclear whether this argument regarding "further support" for a per-unit sewage treatment charge, and other comments in this section of AG's brief, are is referring to customers who use less than 1000 gallons of water, as discussed above, or to all sewage treatment surcharge customers.

The AG gives examples of "disproportionate under-recoveries" in various districts. In the AG's view, IAWC is not managing its purchased sewage treatment costs in a way that results in a predictable or stable cost or rate to consumers. (AG initial brief at 36-38; see also AG brief at 16-17)

According to the AG, "the General Assembly has directed utilities to establish per unit charges for sewer services. There is nothing in the statute to indicate that purchased sewage treatment services should be treated any differently. Indeed, IAWC is charged based on volume." (AG initial brief at 38) The AG believes the lack of consistency and predictability in the purchased sewage treatment charges "further supports the General Assembly's conclusion that a per unit charge is more appropriate (and is required) for sewer services." The AG believes IAWC "should be directed to produce a per unit sewage treatment charge with the goal of stabilizing purchased sewage treatment charges to consumers." (AG Initial Brief at 38)

B. IAWC's Position

IAWC notes that the AG argues that Section 8-306(h) of the Act requires a unit charge for low-volume purchased sewage treatment customers, and that such a requirement overrides the requirement of the Commission's rules in 83 Ill. Adm. Code Section 655.40(b). IAWC says the AG made the same argument in Docket No. 08-0218, where it was rejected. IAWC indicates that the AG did not seek rehearing of this

finding in Docket 08-0218, nor did the AG appeal the Commission's decision. (IAWC Reply Brief at 16-17) That Order stated, in part, on page 9, "The AG‟s assertion that Section 8-306(h) applies generally to sewer rates without modification and provides no basis to exclude purchased sewer services is at variance with the language of the statutes and regulations in question. Section 9-220.2 authorizes the filing of a surcharge to recover purchase sewage treatment charges and Part 655.40(b)(1) and (2) provide the formula to carry out the requirements of Section 9-220.2. Section 8-306(h) does not address purchased sewage treatment services, purchased sewage treatment costs or surcharges, and the Commission cannot identify any language in subsection (h) that could be interpreted as applicable to such services, costs or surcharges."

According to IAWC, the AG claims that the Commission's ruling in Docket No. 08-0218 was "erroneous." IAWC believes this argument is improper and should be rejected as an attempt by the AG to launch a collateral attack on that Order. IAWC asserts that the AG had opportunity to appeal Docket No. 08-0218 and did not. IAWC argues that under the Act, the People's argument that Docket No. 08-0218 was incorrectly decided is barred. (IAWC Reply Brief at 17, citing 220 ILCS 5/10-201(f)); *Peoples Gas, Light & Coke Co. v. Buckles*, 24 III. 2d 520, 528 (1962); *Albin v. Ill. Commerce Comm'n*, 87 III. App. 3d 434, 437 (4th Dist., 1980))

IAWC says that "[i]n it's Initial Brief, the AG raises the argument, for the first time in this proceeding, that there is no evidence in the record to support a monthly surcharge amount for purchased sewage treatment, a charge that is predicated on the basis that IAWC's cost for purchased sewage treatment does not vary based on the strength of waste treated, a prerequisite according to Section 655.40(b)." IAWC insists this is the same argument that the AG unsuccessfully raised in IAWC's previous purchased water reconciliation proceeding, Docket No. 08-0218. IAWC also says that in that proceeding, the AG received copies of all invoices that supported the cost of sewage treatment, and the had opportunity to submit evidence that the cost of sewage treatment varied based upon the strength of waste treated if such evidence existed, but the AG chose not to.

In IAWC's view, the AG's claims that cost of treatment does not vary based on the strength of the waste treated is unfounded as the AG has provided no evidence to support such a claim. IAWC indicates no AG witness even raised the issue in testimony. IAWC asserts that billing invoices submitted into evidence in Docket No. 08-0218 clearly showed that the sewage treatment charges paid to the City of Elmhurst are volumetric in nature and do not include a strength of waste treated component. In addition, IAWC says that Exhibit B for the Country Club, Rollins, and Valley View Districts provide evidence that the purchased sewage treatment charges obtained from billing invoices are based upon a rate per 1,000 gallons of sewage treated and do not vary based on any strength of sewage treated component.

According to IAWC, the record evidence clearly refutes the AG's argument that no basis exists to support a monthly charge amount for purchased sewage treatment. The Company claims it follows the Commission's rules regarding a monthly purchased

sewage treatment charge and such charge is based solely on a supplier volumetric rate. (IAWC Reply Brief at 17-18)

The Company does not believe that this docket is the proper forum to determine whether or not the purchased sewage treatment surcharge should be a monthly or a volumetric charge. While the Company believes that it is following the Commission's rules regarding the setting of purchased sewage treatment rates, the Company will comply with the Commission's order in this docket should the Commission order the Company to convert to a volumetric or some other form of Unit Sewer Rate. (IAWC Reply Brief at 18)

C. Staff's Position

In its reply brief, Staff asserts that the Commission essentially rejected the AG's argument in the Company's 2007 reconciliation proceeding. Staff also notes that the while the AG neither applied for a rehearing of this finding, nor took an appeal from it, the AG now argues that the finding is contrary to law. (Staff Reply Brief at 3-4)

Staff states that the AG has offered one argument in its brief that it has not previously presented: Section 8-306(h) of the Act was enacted after both Section 9-220.2 and 83 Ill. Adm. Code 655 were established and therefore it supersedes anything that came before. Staff says that in essence, the AG argues here that Section 8-306(h) applies generally to all sewer rates, whether for purchased services covered by a surcharge or sewage treatment by the Company, and therefore contends that Section 8-306(h) supersedes all other provisions of the Act that address sewer charges. (Staff Reply Brief at 4)

According to Staff, the AG suggests that unless the statue states a specific exclusion regarding purchased as opposed to Company-supplied, that no distinction can be made between purchased sewage treatment charges through a surcharge and general rate design for base rates. Staff says the Commission has found this argument to be without merit. (*Id*.)

Staff contends that in arguing that Section 8-306(h) acts in entire derogation of Section 9-220.2, the AG demonstrates an imperfect grasp of the rules of statutory construction. Staff says a primary rule of statutory construction is that statutes must be construed as a whole, and the court or tribunal construing it must consider each part or section in connection with the remainder of the statute. (Staff Reply Brief at 4-5, citing *Bruso v. Alexian Brothers Hospital*, 178 Ill. 2d 445, 451-52; 687 N.E. 2d 1014 (1997)) Staff also asserts that a court or tribunal must interpret a statute so that no word, clause or sentence is rendered superfluous or meaningless. (*Id*., citing *Kozak v. Firemen's Retirement Bd.*, 95 Ill. 2d 211, 216; 447 N.E.2d 394, 397; 1983 Ill. Lexis 316 at 7; 69 Ill. Dec. 177 (1983))

Staff states that Section 8-306, of which subsection (h) is a part, was added to the Act by Public Act 94-950. Staff says Section 8-306 uses the word "surcharge" or

"surcharges" no fewer than nine times. Staff adds that Section 8-306(c) requires sewer utilities to provide notice of purchased sewer surcharges. Staff states that Section 8-306(a)(6) contemplates periodic reconciliations under Section 9-220.2. Accordingly, Staff believes the AG's reading of Section 8-306(h) is inconsistent not only with Section 9-220.2, but with other provisions of Section 8-306 itself. Staff contends it is difficult to see how a statute can require that notice be given of a specific surcharge – in this case purchased sewer – and also prohibit it altogether. The AG's construction is, in Staff's view, inconsistent with the rules of statutory construction, and must therefore be ignored. (Staff Reply Brief at 5)

In response to the AG's statement that although the Company is entitled to recover the cost of purchased water, it should manage its rates so that consumer's rates are predictable and current customers pay current charges, Staff says it is not clear what provision of the Act imposes this requirement, as the AG cites none and the Staff is aware of none. (Staff reply brief at 6, citing AG initial brief at 17) Staff also claims that this declaration demonstrates a failure to understand the purpose of collecting under-recoveries and or refunding over-recoveries as a result of annual reconciliations.

According to Staff, the purpose of an annual reconciliation of the actual cost of purchasing the service and the surcharges assessed to customers related to the actual cost is to ensure that the utility only receives reimbursement for its actual costs, and that customers pay the actual cost of providing the service. In Staff's view, the fact that the reconciliations are annual is a reasonably effective way of making certain that current customers pay current charges. (Staff Reply Brief at 5-6)

D. Commission Analysis and Conclusions

In its brief, the AG raised an argument that Section 8-306(h) of the Act requires the Commission to establish a unit rate, in replacement of the current flat rate, to be charged to low-use customers for purchased sewage treatment. The AG also appears to suggest that unit rates could be extended to other customers. Section 8-306(h) states, "Each public utility that provides water and sewer service must establish a unit sewer rate, subject to review by the Commission, that applies only to those customers who use less than 1,000 gallons of water in any billing period."

Staff and IAWC disagree with the AG's position, as discussed more fully above. Among other things, Staff and IAWC argue that the requirement in Section 8-306(h) is inapplicable to a purchased sewage treatment surcharge under Section 9-220.2 of the Act, and that the AG's arguments to the contrary were rejected in IAWC's previous reconciliation proceeding, Docket 08-0218. The AG characterizes the Commission's holding in Docket 08-0218 as "erroneous."

Having reviewed the positions of the Parties, the Commission again finds that the low-use unit sewer rate contemplated in Section 8-306(h) is not statutorily required in a purchased sewage treatment surcharge under Section 9-220.2 for the reasons

expressed by Staff in this proceeding, as summarized above, and by the Commission in its Order in Docket 08-0218. As indicated by Staff, Section 8-306 refers to 9-220.2 surcharges in a number of places. Section 8-306 specifically applies a number of its subsection requirements to 9-220.2 surcharges, but it does not do so with respect to 8-306(h). As stated in the Order in 08-0218, "Section 8-306(h) does not address purchased sewage treatment services, purchased sewage treatment costs or surcharges, and the Commission cannot identify any language in subsection (h) that could be interpreted as applicable to such services, costs or surcharges."

Staff and IAWC also argue that the flat rate in IAWC's reconciliation is in compliance with Section 655.40(b) of Part 655, which states, "For recovery of purchased sewage treatment costs, if the utility's cost for purchased sewage treatment does not vary based on the strength of waste treated, the sewage treatment surcharge shall consist of a monthly charge." Section 655.40(b) also contains various formulas for calculating those monthly charges. There is no indication in this proceeding or in Docket 08-0218 that IAWC's cost of purchased sewage treatment varies based on strength of waste treated. The Commission agrees with Staff and IAWC, as it did in Docket 08-0218, that the flat rate in IAWC's reconciliation is in accord with Section 655.40(b) of Part 655.

Before leaving this topic, the Commission believes a further observation should be made. Although Section 8-306(h) does not require that a unit rate for low-use customers be included in a purchased sewage treatment surcharge implemented under Section 9-220.2, as explained above, the Commission notes that no party has shown such a rate to be prohibited by either statutory section. In the current case, the 8-306(h) issue was not raised until the briefs, and there is not sufficient evidence in the record to show whether a unit charge for low-use customers, or other customers, would be appropriate, or how it should be designed. The Commission is of the opinion that these questions warrant further consideration in future proceedings, and the Commission welcomes input from the parties in that regard.

VII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having reviewed the entire record, is of the opinion and finds that:

(1) Illinois-American Water Company is a corporation that furnishes water and/or sewer utility service to the public in Illinois and, as such, is a public utility within the meaning of Section 3-105 the Act;

(2) the Commission has jurisdiction over the parties hereto and the subject matter hereof;

(3) the recitals of fact and conclusions reached in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact;

(4) pursuant to the terms of IAWC's effective Purchased Water and Purchased Wastewater Treatment Riders, IAWC had surcharges in effect during 2008 for the Alpine Heights, Chicago Suburban, Fernway, Moreland, Southwest Suburban, Waycinden, South Beloit and DuPage County Purchased Water Areas; and the Romeoville, Rollins, Country Club and Valley View Purchased Wastewater Treatment Areas;

(5) IAWC filed revised Information Sheets for the Alpine Heights, Chicago Suburban, Fernway, Moreland, Southwest Suburban, Waycinden, South Beloit and DuPage County Purchased Water Areas; and the Romeoville, Rollins, Country Club and Valley View Purchased Wastewater Treatment Areas effective April 1, 2009, showing revised surcharge rates that reflect the (R) component calculated by IAWC for the reconciliation of Purchased Water and Purchased Wastewater Treatment Rider revenues and costs for calendar year 2008;

(6) the O Factor reflecting an under-recovery to be collected from Purchased Water customers in the Waycinden Area, as well as an over-recovery to be refunded to Purchased Water customers in the Southwest Suburban and South Beloit Areas, as set forth in Appendix A , should be adopted:

(7) the O Factors reflecting an over-recovery to be collected from Purchased Wastewater Treatment customers in the Country Club Area, as set forth in Appendix B, should be adopted;

(8) for the 2008 calendar year, IAWC's Purchased Water and Purchased Wastewater Treatment Rider reconciliations should be approved as shown in Appendices A and B;

(9) the Factor O collections to the Waycinden, Southwest Suburban, South Beloit, and Country Club Areas shall commence with the effective date of the surcharge rates specified in IAWC's next Information Sheet filing;

(10) the under-recoveries collected pursuant to the O Factors shall include interest calculated from January 1, 2009 in accordance with 83 Ill. Adm. Code 655.50(c) and 280.70(e)(1).

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the reconciliation of purchased water and purchased sewage treatment costs and revenues submitted by Illinois-American Water Company for the reconciliation period January 1, 2008 through December 31, 2008, is hereby approved as modified by this Order and reflected in Appendices A and B.

IT IS FURTHER ORDERED that in calculating the surcharge rates for the purposes of the next Information sheet filings for the Waycinden, Southwest Suburban, South Beloit, and Country Club Areas, Illinois-American Water Company shall include,

along with other components specified in 83 Ill. Adm. Code 655.50(c), the O Factors shown in the Appendices hereto.

IT IS FURTHER ORDERED that the O Factors identified in the Appendices hereto, reflecting an under-recovery to be collected in the Waycinden, Southwest Suburban, South Beloit, and Country Club Areas, shall become effective on the effective date of the next Information Sheet filing, expected to be April 1, 2013.

IT IS FURTHER ORDERED that refunds provided under the O Factors placed into effect in accordance with this Order shall include interest calculated from January 1, 2009 in accordance with 83 Ill. Adm. Code Sections 655.50(c) and 280.70(e)(1).

IT IS FURTHER ORDERED that any motions or objections or petitions in this proceeding that have not specifically been ruled on shall be deemed disposed of in a manner consistent with the findings and conclusions contained herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Proposed Order of the Administrative Law Judge this 4th day of May, 2012.

ADMINISTRATIVE LAW JUDGE